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Summary of the Economic and Social Survey of Asia and the Pacific 2013

Summary

Development in Asia and the Pacific is under pressure, with the region being increasingly buffeted by the travails of the developed world. Economic growth in the developed world continued to slow in 2012 as the eurozone fell into a so-called double-dip growth contraction and growth in the United States of America remained anaemic. As a result of the slowdown in demand in the developed world, there was a broad-based deceleration in the Asia-Pacific region in 2012. The generalized downtrend across the region involved such structural issues as rising inequality and shortages in energy and infrastructure owing to past policy mistakes and inappropriate policy responses. The solution to invigorating the domestic drivers of growth in the region lies in making the development process more inclusive and sustainable.

In the *Economic and Social Survey of Asia and the Pacific 2013*, it is argued that the developmental role of macroeconomic policies has been seriously neglected in the region and that this situation has critical implications for poverty, inequality and economic security. The *Survey* therefore argues for a shift in the development paradigm that would require forward-looking macroeconomic policies in order to bring back the balance between stabilization and developmental roles. In the *Survey*, it is advocated that greater emphasis be placed on the quality and composition of public expenditure, rather than aggregate budget deficits or public debts. The *Survey* contains illustrative examples of a set of policies to enhance the region's resilience and inclusiveness; these examples show that the cost of such policies is affordable and fiscally sustainable and would not destabilize the macroeconomy. Such policies include the provision of an employment guarantee for a limited number of days per year, basic social services (education and health care), income security for older persons and persons with disabilities and measures to ensure efficient energy for all by 2030.

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The Economic and Social Commission for Asia and the Pacific may wish to deliberate on these issues and propose policy recommendations for promoting inclusive and sustainable development in the region.

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I. Introduction

1. The Rio Declaration on Environment and Development,[1] emphasizes that environmental protection and social development must be integral parts of the development process. Each of these areas has a distinct focus in addition to economic development; yet, all three are mutually reinforcing and interdependent. The need to mainstream all of them into the development policies and programmes of all countries was reaffirmed at the United Nations Conference on Sustainable Development (Rio+20), held in Rio de Janeiro, Brazil, in June 2012.

2. The global leaders gathered at the Rio+20 Conference also called for the adoption of forward-looking macroeconomic policies that promote sustainable development and lead to sustained, inclusive and equitable economic growth. In recognizing the lessons learned and successful policies and approaches in the implementation and achievement of the Millennium Development Goals, Government leaders made the same call in September 2010 in the outcome document of the High-level Plenary Meeting of the sixty-fifty session of the General Assembly.[2]

3. For the Asia-Pacific region, the term "inclusiveness" needs to be explicit since the miracle of rapid economic growth has been uneven. Despite significant reductions in poverty, the region is still home to more than 800 million poor people, accounting for nearly two thirds of the world's poor, who struggle to survive on an income of less than $1.25 a day. An almost equal number of people in the region are "near poor" or remain vulnerable to poverty, using the $2-per-day poverty line. Moreover, income inequality has risen and economic security has deteriorated amid rapid economic growth. More than 1 billion workers in the region are in vulnerable employment and more than 500 million people remain undernourished.

4. The situation is not helped when most Asia-Pacific developing countries do not have a comprehensive social protection system to assist people in regenerating their livelihoods when they have been affected by economic crises, natural disasters or personal misfortunes. Thus, despite showing remarkable resilience to economic crises, the people living in this region are becoming increasingly vulnerable to them.

5. Enhancing resilience and the inclusiveness of the development process must therefore be explicitly recognized as key priorities for the Asia-Pacific region. Because of their interconnectedness, development strategies aimed at enhancing resilience and inclusiveness mutually reinforce each other and thereby strengthen all three pillars of sustainable development.

6. The *Economic and Social Survey of Asia and the Pacific 2013* examines how the ongoing global economic crisis is affecting the inclusiveness and sustainability of the region's development process and the extent to which its impacts are exacerbated by structural impediments caused by past policy inadequacies. The *Survey* argues for a shift in the development paradigm that would require forward-looking macroeconomics in order to restore the balance between stabilization and developmental roles of macroeconomic policies. There has to be greater emphasis on the quality and composition of public expenditure rather than aggregate budget

[1] See *Report of the United Nations Conference on Environment and Development, Rio de Janeiro, 3-14 June 1992*, vol. I, *Resolutions Adopted by the Conference* (United Nations publication, Sales No. E.93.I.8 and corrigendum), resolution 1, annex I.

[2] General Assembly resolution 65/1.

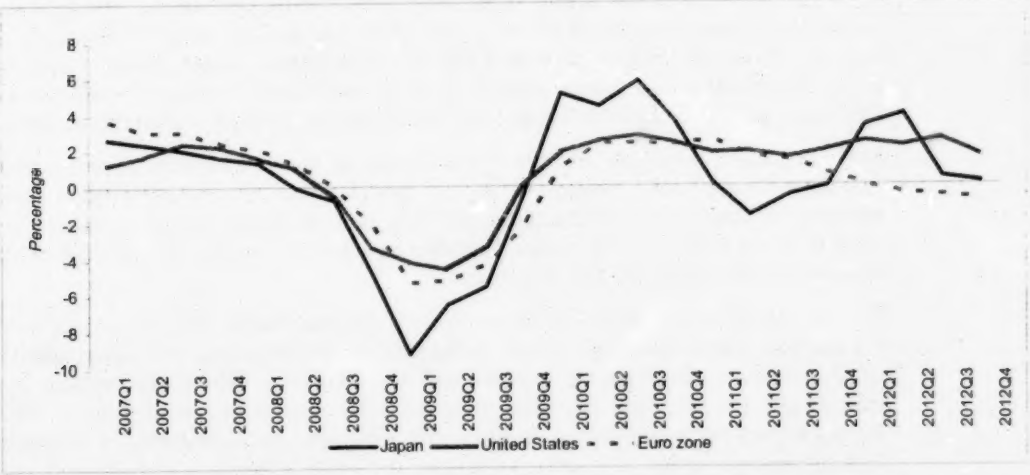
deficits or public debts. The *Survey* also provides some illustrative examples of a set of policies to enhance the region's resilience and inclusiveness, with estimates of their fiscal cost.

7. These forward-looking policies include the provision of an employment guarantee for a limited number of days per year, basic social services (education and health care), income security for older persons and persons with disabilities and measures to ensure that there will be efficient energy for all by 2030. The required investment for this policy package is affordable and fiscally sustainable and will not destabilize the macroeconomy. Importantly, "social protection must not simply be seen as a handout. It is an investment in inclusive growth. It is an investment in human capabilities to get people out of exclusion and poverty and to build resilience to risks and vulnerabilities".[3]

II. Growth outlook to remain subdued

8. Development in Asia and the Pacific is under pressure, with the region being increasingly buffeted by the travails of the developed world. Economic growth in the developed world continued to slow as the eurozone fell into a so-called double-dip growth contraction, and growth in the United States of America remained anaemic (see figure 1 below). As a result of the slowdown in demand in the developed world, the Asia-Pacific region experienced a broad-based slowdown in 2012.

Figure 1
Real GDP growth in major developed economies, quarter by quarter, year on year, 2007-2012

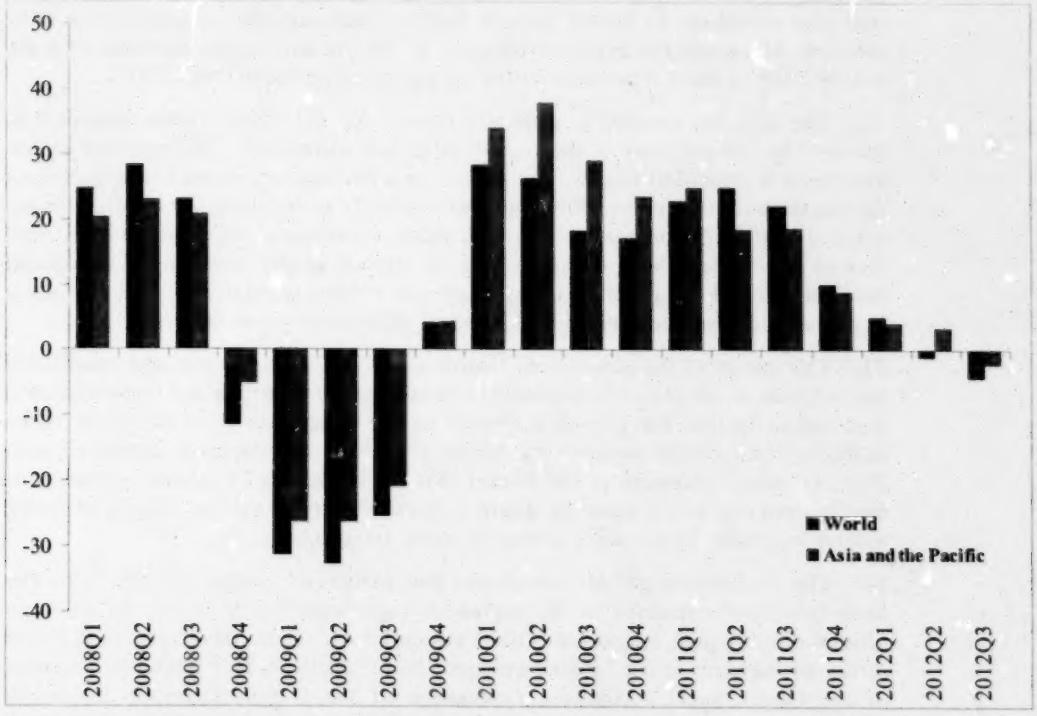


Source: Economic and Social Commission for Asia and the Pacific (ESCAP), based on data from CEIC Data Company Limited, available from http://ceicdata.com.

[3] Noeleen Heyzer, Keynote speech at the Regional Conference on Enhancing Social Protection in Asia and the Pacific, held at the Asian Development Bank Headquarters in Manila, on 21 and 22 April 2010.

9. A number of large economies in Asia and the Pacific, most notably China and India, which proved resilient in the early part of the crisis, also slowed markedly in 2012; this situation reduced the level of support to other Asia-Pacific economies previously provided through the channel of intraregional demand. As a result of the generalized slowdown, the Asia-Pacific region started to experience a contraction in trade after mid-2012 (see figure 2 below).

Figure 2
Recent developments in export growth in the Asia-Pacific region
(Year-on-year percentage change)



Source: ESCAP calculation, based on World Trade Organization online short-term merchandise statistics (accessed in February 2013).

10. There was some diversity in economic performance across subregions. The South-East Asian subregion as a whole achieved higher economic growth in 2012 than in 2011, despite weakening external demand. Private consumption was strong and supported by policy measures, such as minimum wage increases, while investment benefited from increased public infrastructure outlays. All the economies in the East and North-East Asian subregion, except Japan, registered lower growth rates in 2012. However, the gross domestic product (GDP) growth rate in China was still among the highest in the world. Although economic performance in the North and Central Asian subregion remained robust at the beginning of 2012, most economies began to feel the impact of the deteriorating external economic environment in the latter part of the year. The Pacific island developing economies generally slowed in 2012. Papua New Guinea, a resource-rich economy that is the

largest in the subregion, continued to achieve high growth but at a slightly lower rate compared with 2011. Although growth performance in many of the countries in the South and South-West Asian subregion is less dependent on foreign demand, the global slowdown has still had an adverse impact on exports and consequently on economic growth. Moreover, domestic demand, particularly investment, has also been characterized by slower growth.

11. The near-term economic performance of the region is likely to pick up in 2013 but will still be below its growth potential. Developing Asia-Pacific economies as a group are projected to expand by 6.2 per cent in 2013, up slightly from 5.7 per cent in 2012.[4] Within the region, the effects of earlier policy easing and fiscal stimulus will also contribute to higher growth, but any improvement in prospects will be subdued. Moreover, the expected rebound in 2013 is still below the trend of 8 per cent in 2010/11 and 8.5 per cent during the pre-crisis period of 2002-2007.

12. The inflation forecast is generally modest for 2013, with prices projected to increase by 5.0 per cent in the region. Although inflation is not expected to rise sharply, it is important to note that prices are high, causing severe hardship among the poorest and most vulnerable sectors of society in many economies. Furthermore, while overall inflation may not rise in many economies, the key food and fuel sectors may face price pressure owing to global supply concerns. The overall moderate outlook for inflation is due to growth remaining relatively weak, resulting in reduced domestic demand-pull factors and inflationary expectations.

13. The impact of the generalized slowdown in 2012 on inclusive and sustainable development in the region is expected to be substantial, with job and income growth expected to decline. Job growth is already on the wane, with 10 of the 13 countries in the region recently sampled exhibiting a year-on-year decrease compared with 2011. Of critical concern is the impact that the slowdown in income growth will have on poverty and inequality. There is great anxiety about the impact of rising income inequality on the achievement of social indicators.

14. The challenging global outlook has had particularly important effects on the least developed countries in the region. A significant worry is the reduction in official development assistance (ODA) commitments of the developed world as a direct consequence of the "great recession". Net ODA flows from member countries of the Development Assistance Committee of the Organization for Economic Cooperation and Development (OECD) amounted to $133.5 billion in 2011, a decline in real terms of 3 per cent, thus widening the delivery gap in meeting the internationally agreed aid targets of 0.7 per cent of gross national income, which would amount to $167 billion.[5] Under these constrained circumstances, least developed countries have still received considerable support as a result of the ongoing remittances contributed by their overseas workers. Asia-Pacific economies received a record $219 billion in remittances in 2012, with Bangladesh and Nepal being among the top 12 recipients in the region in terms of value and proportion of GDP.[6] While the growing comparative role of remittances as a source of capital is

[4] Data and projections as at 5 March 2013.

[5] *World Economic Situation and Prospects 2013* (United Nations publication, Sales No. E.13.II.C.2), p. viii. Available from www.un.org/en/development/desa/policy/wesp/wesp_current/wesp2013.pdf.

[6] Dilip Ratha and Ani Silwal, "Migration and Development Brief 18", (Washington D.C., World Bank), 2012. Available from http://siteresources.worldbank.org/INTPROSPECTS/Resources/334934-1110315015165/MigrationandDevelopmentBrief18.pdf.

welcome, their primary significance remains confined at the household level, namely, providing livelihood support and opportunities to escape poverty. Furthermore, since many of these remittances have been generated from within the region, this trend may not last if the generalized slowdown in the region deepens. Therefore, it is important to bear in mind that ODA continues to remain important for developing economies owing to the critical role that it plays in budget support for the provision of such public goods as roads, water supply, education and health care.

15. The slowdown in the two developing powerhouses in the region, China and India, has been the key new fear for the smaller economies in the Asia-Pacific region, adding to existing difficulties in recent years stemming from the crisis in the developed world. The slower growth in the region's major economies will have immediate demand impacts for the smaller exporting economies. However, a more positive development in the medium term is likely to occur as a result of the increased rebalancing in China as it attempts to become a more consumption-led economy in line with the Government's efforts to address the problem of growing inequality and regional imbalances by bolstering the income of the poor, particularly in rural areas, through the stimulation of economic activity in rural and less developed regions. Such a policy approach can produce a net positive impact on other countries in the region by creating new sources of demand in China's economy.

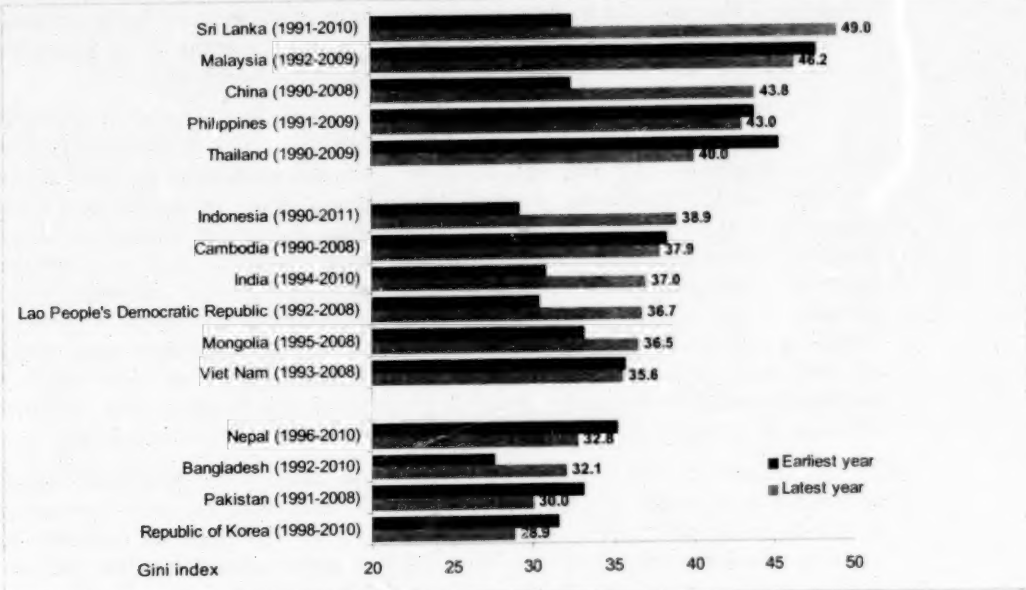
16. Confronted by the challenges of slowing demand in the developed world, economies in the region will have to look towards undertaking supportive measures at the domestic and regional levels to maintain their development progress. In addition, Governments will have to take action to ensure specifically that the jobs and incomes of the poorest and most vulnerable sections of society are protected during this difficult period. One of the policies that is gaining increased resonance in the region is the introduction of minimum wage requirements to ensure the livelihoods of citizens.

III. Structural impediments to continued progress

17. The generalized deceleration across the region in 2012 points to structural issues, such as rising inequality, and energy and infrastructure shortages, owing to past policy mistakes and inappropriate policy responses. The underlying causes of the difficulties currently being faced go beyond the impacts emanating from the developed world. The slowdown even among the economies in the region with large domestic markets clearly demonstrates the shortcomings of the development strategies that have been pursued over the past few decades.

18. Key evidence of structural deficiencies are demonstrated, for instance, by the fact that declines in poverty in the region have been accompanied by greater levels of inequality (see figure 3 below). Inequality in the region has been exacerbated by the failure of fiscal policy to play its distributional role through making the tax structure broad-based and more progressive and providing for increased expenditure in the public provisioning of essential services, including social protection. In fact, Asia-Pacific economies as a group have the lowest tax burden of any developing region in the world. There is a clear negative relationship between the tax burden of countries in the region and their levels of inequality. The negative relationship is more pronounced between public social expenditure and levels of inequality.

Figure 3
Income inequality in selected Asia-Pacific developing economies, 1990s, and latest available data



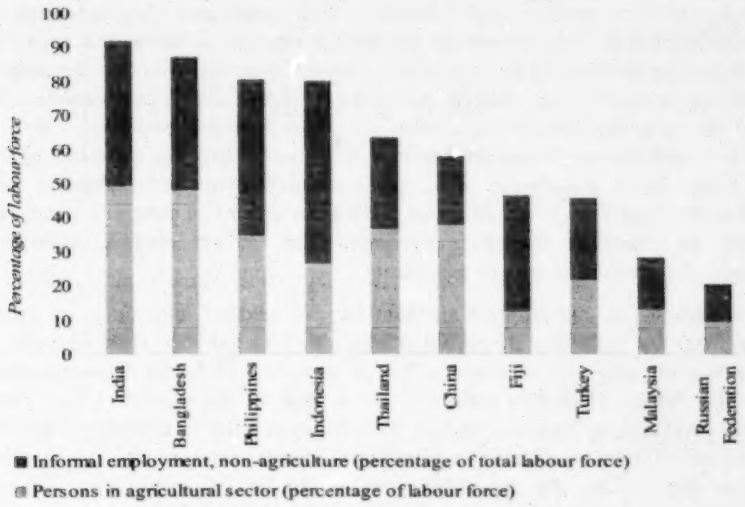
Source: World Bank, PovcalNet data, supplemented by household survey data from India and the publications of the National Statistical Office of the Republic of Korea.

19. In spite of significant progress in recent years in a number of countries, including through extending the provision of basic health-care access and income support to poor workers and households, Asia-Pacific countries still exhibit significant shortcomings in their social protection regimes. Public social security expenditure remains low at less than 2 per cent of GDP in half the countries where data are available. In addition, only 30 per cent of persons older than 65 years of age in Asia and the Pacific on average receive a pension, and only 10 per cent of the unemployed receive any benefits.[7] Vulnerable employment is a persistent issue within the Asia-Pacific region (see figure 4 below). Despite high rates of economic growth within East Asia, more than half the region's workforce has a vulnerable employment status. This figure is considerably higher in South Asia.[8]

[7] International Labour Organization, *World Social Security Report 2010/11: Providing Coverage in Times of Crisis and Beyond* (Geneva, 2010); and Florence Bonnet, Catherine Saget and Axel Weber, "Social protection and minimum wages responses to the 2008 financial and economic crisis: findings from the ILO/World Bank Inventory", Employment Working Paper No. 113 (Geneva, International Labour Organization, 2012).

[8] International Labour Organization, *Asia-Pacific Labour Market Update* (April 2011). Accessed on 19 November 2012. Available from www.ilo.org/wcmsp5/groups/public/---asia/---ro-bangkok/documents/publication/wcms_154215.pdf.

Figure 4
Informal unemployment as a percentage of the total labour force



Source: ESCAP, based on the World Bank's World Development Indicators database.

20. Vulnerability of employment and inequality are both inimical to domestic demand. As indicated previously, inequality and vulnerability have been exacerbated by the failure of Governments to raise tax revenues through a broad-based and progressive tax structure. This has constrained their ability to spend on basic social services, including social protection. Progressive taxation and social protection measures not only reduce inequality, but also lessen vulnerability by acting as automatic stabilizers. Low tax revenue restricts Governments' fiscal space and hence their ability to boost domestic demand when needed. Therefore, reform of the tax structure, including improving the efficiency of tax administration and widening the tax base, is of utmost urgency for most Asia-Pacific countries, especially when they have to find domestic drivers of growth in the face of diminished prospects for exports.

21. The Asia-Pacific region suffers from large infrastructure deficits, although there are significant variations among countries. Infrastructure deficit is clearly an impediment to growth, especially in South Asia. Investment climate assessment surveys of firms in South Asia show that infrastructure is a "major" or "severe" obstacle to business expansion. Power is the most critical bottleneck, with transportation being a close second. Traffic congestion has become a common feature in most Asian cities, but its costs can be as high as 2 per cent of GDP.

22. Agriculture accounts for a quarter of GDP in the region's developing countries; this sector employs about 60 per cent of the region's working population and accounts for the majority of the poor. Yet, the agricultural sector has suffered from decades of neglect, as pointed out in the *Economic and Social Survey of Asia*

and the Pacific 2008.[9] This has weakened the sector's capacity to cut poverty and inequality. Structural impediments to productivity growth in agriculture include inequality in land ownership, lack of human capital development owing to limited access to health-care services and education, and inadequate rural infrastructure. These impediments are largely owing to macroeconomic policies that resulted in declines in public investment in agriculture, especially in research and development and extension services, and cuts in agricultural credit and input subsidies. The neglect of the rural and agricultural sector is evident from the inequalities that exist in access to health-care services, education and infrastructure. For example, nearly a quarter of the rural population does not have access to safe drinking water, compared with 7 per cent in urban areas. Less than a third of people in rural areas have access to improved sanitation, compared with 70 per cent in urban areas. Similar gaps also exist in access to education.

23. Improvement in agricultural productivity is needed not only to provide insulation from the volatility of global markets and to enhance food security, but also to reduce poverty and inequality. The Economic and Social Commission for Asia and the Pacific (ESCAP) estimates show that an increase of 1 per cent in agricultural productivity would lead to a 0.37 per cent drop in poverty in the Asia-Pacific region. Given the large agricultural labour productivity gaps among countries in the region, the potential gains would be substantial. For example, raising the region's average agricultural productivity to that of Thailand could lift 218 million people out of poverty.

24. Industrialization and an expanding and increasingly affluent consumer base have boosted the demand for all kinds of resources. Trends in the use of biomass, energy, construction and other minerals show that, while the economies of other regions of the world are becoming less resource-intensive over time, the Asia-Pacific region is requiring more resources to produce a dollar of GDP as the economy grows. While growing affluence is mainly to blame for environmental pressures related to resource use, persistent inequality with regard to access to basic services is also implicated. Some 800 million people are without access to modern forms of energy, mainly in rural areas. This situation constrains overall socioeconomic progress, and lack of access to electricity also drives a vicious cycle in which the need for wood and other biomass-based forms of energy promotes extraction from the natural environment.

25. The perception that intensive resource use and environmental degradation are acceptable phenomena in a "grow now, clean up later" approach to development is imposing significant socioeconomic costs — costs most often borne by the most vulnerable in society. Extreme weather events, which may be related to climate change, add to these costs. Economic losses are just one facet of the implications of resource-intensive growth patterns for development. In a joint ESCAP, Asian Development Bank and United Nations Environment Programme (UNEP) publication,[10] it is pointed out that, while there is a need to continue to elevate standards of living, this must be achieved based on resource-efficient, rather than

[9] United Nations publication, sales No. E.08.II.F.7.

[10] See ESCAP, Asian Development Bank and United Nations Environment Programme, *Green Growth, Resources and Resilience: Environmental Sustainability in Asia and the Pacific* (ST/ESCAP/2600) (Bangkok, 2012). Available from www.unescap.org/esd/environment/flagpubs/ggrap/documents/Full-Report.pdf.

resource-intensive, growth strategies. In a context of high and volatile resource prices and increasingly evident resource constraints, a resource-intensive growth pattern translates into an economy with higher exposure to risk, especially for the most vulnerable in society. Resource efficiency is increasingly an economic risk management strategy on both economic and social fronts.

26. The region faces other types of risk as well. Asia and the Pacific is the world's most disaster-prone region. In 2012, floods and storms were the most frequent type of disaster in the region and had the greatest human and economic impact. Vulnerability to disasters continues to increase while economic development is exposing ever-growing numbers of people and assets to disasters. Never before has the need for collaborative action to reduce risk, vulnerability and exposure of populations and assets been more obvious and necessary for the common good. The shared challenge in Asia and the Pacific is to control both the growing rate of exposure and rising vulnerability. Well-targeted investment in disaster risk reduction and management can reduce vulnerability and exposure to disasters. Social protection, designed in a more resilient manner by taking into account poverty alleviation and focusing on the underlying causes, can reduce people's vulnerability during and after a disaster event. Scaling up vulnerability reduction measures in high-risk areas, land-use planning, supply chain management and targeted social safety nets for the most vulnerable within a universal social protection system have the potential to significantly reduce disaster risks. Furthermore, regional cooperation can be used for cost-effective sharing of highly sophisticated and sometimes costly information and communications technology and space technologies.

27. In addition to structural impediments faced by the region in general, some constraints and challenges are more specific to various subregions. Income inequalities and population ageing are major concerns in East and North-East Asia. Policymakers are conscious of the need to adapt the broad normative and institutional environment in a way that is conducive to more inclusive and sustainable development. In the South-East Asian subregion, productive jobs, social protection and clean energy are among the key challenges for achieving inclusive and sustainable development. North and Central Asia continue to face serious challenges owing to their reliance on commodity exports, including oil and gas, making them highly exposed to the external economic environment. Further diversification of these economies will always remain a challenge. Since most of these countries are landlocked, trade and transit issues are highly relevant to them. The Pacific island developing economies face unique challenges, including small populations, a poor resource base (except in a few exceptional cases), remoteness from their more developed trading partners, frequent natural disasters and adverse impacts from global climate change. These constraints make it difficult for them to achieve high economic growth rates on a sustained basis. South and South-West Asia, which is home to the highest number of poor and malnourished people compared with all other subregions in Asia and the Pacific combined, needs to maximize its growth potential and increase productive employment opportunities by reviving industries in order to further reduce poverty and hunger.

A. The solution: inclusive and sustainable development

28. The solution to invigorating the domestic drivers of growth in the region lies in making the development process more inclusive and sustainable. In the social sphere,

making development more inclusive will spur consumption by the majority of the population in many developing economies, namely, the poorest and most vulnerable members of society. Improvement in taxation bases, tax administration and tax progressivity will also be important for generating necessary revenues to fund both ongoing economic development and a supporting regulatory environment for improved social and environmental performance. The resultant shift towards a more inclusive development paradigm would ultimately set the course to ensure sustainable development in the Asia-Pacific region. In the environmental sphere, the current failure of countries to tackle degradation in their natural environment is impeding the ability of their economies to perform at their full potential. Issues that have a direct bearing on the quality of economic growth include deforestation, damage to water and energy sources, and air pollution. The approach to addressing the social and structural deficits lies in Government action.

B. Regional cooperation in times of uncertainty

29. There is always a danger of competition among countries when they are all facing shrinking export markets and experiencing declines in foreign investment. Countries must avoid a race to the bottom by competing among themselves to lure foreign investment, often with tax concessions or by applying easier terms with regard to protection of the environment and labour rights. Such beggar-thy-neighbour policies do not help any country in the end, and they are harmful to inclusive and sustainable development. Instead, countries should enhance regional cooperation, in particular in addressing their large infrastructure deficits and other impediments that are cross-border in nature. Rather than undermining an individual country's efforts, countries should act together to raise the living standards of their people, for example by increasing the minimum wage, which would expand regional markets for all of them.

Forward-looking macroeconomics for resilient, inclusive and sustainable development

30. Macroeconomic policies that evolved in industrialized countries in the era following the Second World War were aimed primarily at achieving internal balance, defined as full employment and price stability, and external balance, defined in terms of "equilibrium" in the current account component of the balance of payments. However, the breakdown of the Bretton Woods system of fixed exchange rates and the oil price shocks in the 1970s led to a de facto abandonment of the principle of balancing growth, full employment and price stability. Henceforth, internal balance was confined to price stability in the belief that such balance and everything else, including economic growth, would follow. Consequently, fiscal policy was stripped of its developmental and redistributive roles as low budget deficits were now regarded as essential for keeping inflation low and the balance of payments sustainable.

31. The excessive focus on stabilization led to neglect of the developmental role of macroeconomic policies. This has had serious implications for poverty, inequality and economic security. Moreover, advice to Governments to reform their tax structure by reducing direct (income and corporate) taxes and increasing indirect taxes reduced tax progressivity and its ability to serve as a redistributive tool. Cuts in public provisioning of basic social and economic services and the introduction of

the user-fee principle contributed to increasing inequality, even where there was rapid economic growth. The diminished fiscal space has limited the ability of Governments to pursue countercyclical fiscal policies; worst of all, the focus on aggregate debts and deficits or inflation made macroeconomic policies procyclical.

C. Bringing back the balance: stabilization is necessary but not sufficient

1. Fiscal policy: the composition of Government expenditure matters

32. As emphasized in the *Economic and Social Survey of Asia and the Pacific 2009*,[11] the composition of Government expenditure clearly matters. For instance, public investment in developing countries is crucial, especially in areas characterized by lumpy investments, long gestation lags and relatively lower profits, all of which make the private sector unwilling to enter such areas. Critical areas include infrastructure, health care, education and social security, all of which have important positive growth effects. The front-loading of massive public investments is important, particularly in the areas of renewable energy and smallholder food agriculture, to induce complementary private investments. This is even more the case in the context of the ongoing global economic recession and high volatility of food prices. Public procurement can be used to direct production and consumption towards greener and more labour-intensive activities.

33. Governments can also use public procurement to direct production and consumption towards greener and more labour-intensive activities. Government procurement expenditures are a significant source of aggregate demand in Asian and Pacific countries. In a sample of 19 countries, including Australia, China, India, Japan, New Zealand and the Russian Federation, the total of such expenditures amounted to $582 billion in 2010.

34. In 2010, Governments in Asia and the Pacific allocated 18.6 per cent of their total expenses to procurement, an amount that is between the corresponding figures for countries in the European Union (13.8 per cent) and for North America (22.1 per cent). Moreover, several countries spent a larger share of their general Government expenses on procurement that year, ranging from 28.2 per cent in New Zealand to 43 per cent in Kazakhstan. With such large expenditures on procurement, Asia-Pacific countries could leverage the private sector towards greener and more labour-intensive activities. This type of action can be an important fiscal policy instrument for inclusive and sustainable development.

35. There should thus be more scrutiny of the composition of fiscal expenditure instead of overall deficits or debts. This is particularly the case since, in the past, countries suffering from high and unsustainable debt generally have either spent on unproductive sectors or have failed to collect enough revenue when the economy was growing.

2. Monetary policy: targeting very low inflation can hurt growth

36. Policymakers are usually advised to target inflation at a low single-digit level. Yet, a large number of studies show that the relationship between inflation and

[11] United Nations publication, sales No. E.09.II.F.11.

growth is non-linear — positive up to a moderate level and negative thereafter. The threshold beyond which inflation adversely affects growth varies. It is higher for countries at an early stage of development. For example, several Asia-Pacific developing countries grew amid relatively high inflation, including Indonesia, Kyrgyzstan, the Lao People's Democratic Republic, Mongolia, the Republic of Korea, Sri Lanka, Tajikistan and Uzbekistan. In these countries, growth performance exceeded 5 per cent amid high inflation.

37. Contrary to common belief, moderate inflation may not harm efforts to reduce poverty. Poverty rates dropped dramatically in both Indonesia and the Republic of Korea between the mid-1960s and the mid-1980s despite an inflation rate ranging from 13 per cent to 17 per cent. Although inflation results in lower real wages, it also encourages firms to expand employment. Several studies have found that the employment effect of moderate inflation is larger than its real wage effect, resulting in a net positive effect on poverty reduction. Inflation also reduces the real value of debt and is therefore likely to benefit the poor, who are usually net debtors. Monetary policy that controls price inflation, especially inflation that is caused by supply shocks, may harm the poor if it causes job loss, particularly since unskilled workers usually lose jobs first. Therefore, as a rule, monetary authorities should not react to inflation without first analysing its causes and disaggregated impacts.

38. The targeting of inflation at too low a level can constrain growth, especially when it is achieved by keeping interest rates high, since access to finance is critical, particularly for small and medium-sized enterprises and agriculture. While monetary tightening to tackle inflation caused by supply shocks or rising food and fuel prices exacerbates adverse impacts on growth and employment, moderate inflation keeps real interest rates low and hence boosts investment. It also expands fiscal space through inflation tax (seignorage) and lower interest payments on debt.

3. Financial policy: financial deregulation and financial inclusion

39. Central banks play an important role in development. By reducing entry barriers and promoting financial inclusion through changes in the regulatory framework to encourage "banking agents", central banks can strengthen development. In the past, they were also able to ease the constraint of access to credit by firms through credit allocation policies. This played an important role in, for instance, the implementation of the strategy promoting heavy and chemical industries in the Republic of Korea and the decisive shift in credit deployment in favour of agriculture that occurred in India in the 1970s and 1980s. However, as a result of financial sector deregulation in the 1980s, there was a rollback of credit directed by specialized financial institutions to farmers and small and medium-sized enterprises. In particular, the pressure to be profitable, measured by the short-term criteria of volatile stock markets, has led to a wave of bank mergers and the exclusion of small and medium-sized enterprises and small borrowers from formal credit markets. With regard to financial sector deregulation, there has been an increase in banking and financial crises, which has had devastating impacts, particularly on the poor and middle-class people. Countries therefore need to revisit financial sector deregulation and strengthen prudential measures, as well as enhance financial inclusion.

4. Exchange rates and development

40. The choice of exchange rate regime is important since exchange rates have interdependent microeconomic and macroeconomic roles. They play an important microeconomic function of structural change between tradable and non-tradable sectors of an economy, and maintaining international competitiveness. The importance for macroeconomic policy lies in the close association between balance of payments outcomes, budget deficits and monetary policy stance. Exchange rates can impose discipline on macroeconomic policy by constraining the Government's ability to pursue unsustainable budget deficits resulting primarily from unproductive spending through the printing of money.

41. In the past three decades, many developing countries have officially moved away from a fixed exchange rate regime. Yet, their exchange rate regime is often not fully flexible in practice. Although it is argued in numerous studies that greater flexibility is not always an optimum policy for the developing world, past currency crises continue to prompt suggestions for more exchange rate flexibility. This is not, however, a panacea for all problems. Rather, countries should target exchange rate stability. This is vital for promoting economic growth and prosperity through international trade. It also has an important bearing on poverty reduction. Targeting exchange rate stability may, however, mean a certain loss of monetary independence if the country concerned cannot retain some control over short-term capital mobility or if capital mobility is significant.

5. Enhancing policy space and mitigating financial sector fragility through the management of capital flows

42. Private capital flows to emerging markets continue to surge since many developing countries have better growth prospects and interest rates are higher than in advanced countries. These inflow surges create significant policy challenges and are highly disruptive to development since they put upward pressure on exchange rates and dent export competitiveness. They can also increase inflationary pressures and trigger asset bubbles if reserve accumulation is left unsterilized.

43. Alongside monetary, fiscal and exchange rate policies, capital flow management is therefore an important measure to address the macroeconomic and financial stability risks associated with such capital surges. Several countries, including Indonesia, the Republic of Korea and Thailand, successfully introduced defensive measures against capital flows during the global financial and economic crises.

44. Managing capital flows is a country's sovereign right. Although opening the capital account is often seen as essential for enhancing investment, empirical evidence of the growth-enhancing effect of capital account liberalization is mixed. First, capital account convertibility reduces the impact of growth on poverty reduction by making after-tax income distribution more unequal. As capital account liberalization makes it easy for foreign direct investment to leave a country, developing countries end up offering various tax concessions to remain attractive. This shifts the tax burden from capital income to labour income. Second, the prospect of capital flight also forces Governments into a conservative fiscal policy stance, which often results in cuts in Government expenditure, especially in the social and infrastructure sectors. This restricts the ability to address priority sector development and human development. Third, capital account opening at lower

levels of development usually increases capital outflows. Countries also often respond with higher domestic interest rates, which adversely affect domestic investment. Moreover, high domestic interest rates may attract capital inflows but can adversely affect a country's international competitiveness and pace of industrialization owing to the "Dutch disease", namely, the apparent relationship between increased exploitation of natural resources and a decline in the manufacturing sector.

45. Capital account openness should therefore not be viewed as an all-or-nothing proposition. Rather, managing short-term capital flows can be beneficial to developing countries as it reduces the possibility of crises arising from volatile international capital flows. It also insulates domestic interest rates and the exchange rate and makes some room for expansionary monetary policy. In sum, prudential management of capital flows enhances both the stabilization and developmental roles of macroeconomic policies.

D. Investing in human development

46. Large development gaps in the region and within countries suggest that greater involvement of the State may be needed to address persistent macroeconomic, social and ecological imbalances in an integrated manner. To foster inclusive and sustainable development, Governments should pursue public policy actions that are based on the current economic, social and environmental situation and needs of the region. Strategies should address economic, social and environmental imbalances simultaneously, taking into account the impacts of policy measures on the three imbalances and giving the highest priority to policies that address more than one imbalance at the same time.

47. The provision of basic public services to all will be a critical element in making growth more resilient, inclusive and sustainable in the region. Six critical actions are: the provision of employment for all; income security for the elderly; income security for persons with disabilities; health care for all; education for all; and energy access for all.

E. Employment for all

48. Full employment as a goal is enshrined in the Charter of the United Nations (Article 55). High rates of unemployment and pervasive vulnerable and underemployment hamper growth and development. The inability of large proportions of the labour force to earn a safe and decent living limits their capacity to accumulate savings, leading to a low level of capital available for investment. It also limits their ability to invest in health and education, thus increasing the vulnerability of current and future generations. Concerted efforts to foster job creation should therefore represent a core element of national development policy in Asia and the Pacific. By providing employment opportunities through public works programmes or job guarantees, for instance, Governments would provide an important safety net for vulnerable workers and workers in the informal sector by providing them with a guaranteed source of income for a specified amount of time. Similarly, wage subsidies and employment opportunities, such as apprenticeships linked to active labour market programmes, could stimulate demand or provide incentives for re-employment.

49. Job guarantees and wage subsidies would also have important spill-over effects on national economies. For instance, programmes focused on infrastructure development could enhance productive capacities. If designed carefully, such programmes could also contribute to the greening of economic and productive capacity. Investments and expenditure that target social infrastructure can create additional employment and improve access by rural communities to basic social services.

50. Providing a 100-day employment guarantee that pays a wage equivalent to the national poverty line to everyone in the informal sector would not require large resources: in China and the Russian Federation just over 1 per cent of GDP; in Bangladesh, up to 8 per cent of GDP.

F. Income security for the elderly

51. Since the population is ageing in a large number of countries in the region, increased attention must be paid to the income security of older persons. When people grow older, their living standards often decline, usually as a result of reduced economic opportunities and a decline in their health status. Traditionally, societies in the Asia-Pacific region have relied on informal family-based support systems for old-age income security. However, rapid rates of urbanization and other social changes are contributing to a breakdown in these informal generational contracts. The vulnerability of older persons, especially in the informal sector, thus calls for the introduction of a mechanism that provides some form of income security for such persons.

52. While almost all countries in the region have a formal pension scheme, in general, coverage is skewed towards urban areas and the formal sector. Overall coverage of the labour force is relatively low: in developing Asia, an estimated 8 of every 10 workers are not covered. This implies that many persons, especially those who are single, widowed or childless (particularly women), face a high risk of destitution in old age. Several countries have introduced programmes in which eligibility is based on having reached a certain age and benefits are not means-tested. In Nepal, for instance, such a scheme was introduced in 1995; Brunei Darussalam has had one since 1984. Such schemes should be introduced more widely across the region. Overall, the cost of providing all persons over 65 years of age with a universal pension that is equivalent to the national poverty line would range between 1 and 4 per cent of GDP over the medium term (by 2030).

G. Income security for persons with disabilities

53. Approximately 650 million persons with disabilities live in the Asia-Pacific region. The limited availability of social protection in developing countries in Asia and the Pacific leaves this vast section of the population without sufficient coverage. According to an ESCAP study,[12] more than 70 per cent of persons with disabilities

[12] United Nations, Economic and Social Commission for Asia and the Pacific, *Disability, Livelihood and Poverty in Asia and the Pacific: An Executive Summary of Research Findings* (ST/ESCAP/2643). Available from www.unescap.org/sdd/publications/DL/SDD-Disability-Livelihood.pdf.

do not have enough income for self-support. This contrasts with many of the OECD member countries, which have generous disability benefits in place for a relatively large proportion of the population. It is therefore crucial that these persons have access to social protection on an equal basis with others. Providing the disabled with benefits equivalent to the national poverty line would cost far less than 1 per cent of GDP in the Asia-Pacific region.

H. Health for all

54. At the High-level Meeting of the General Assembly on the Prevention and Control of Non-communicable Diseases, in September 2011, Member States committed themselves to an all-out attack on such diseases as part of their campaign to achieve health for all (see resolution 66/2, annex). In 1981, the Global Strategy for Health for All by the Year 2000 was adopted, marking the birth of the "health for all" movement (see resolution 36/43).

55. Although tremendous improvements in health outcomes have been registered in the region since 1981, public health-care coverage can still be improved in many countries. Public health expenditure is particularly low in the least developed countries in the region. Moreover, inequities in health within countries in the region can be significant.

56. In recognizing that universal health-care coverage is a critical component of inclusive and sustainable development, in 2011, 193 member States of the World Health Organization (WHO) committed to move towards universal health-care coverage. However, progress has been patchy, especially in the Asia-Pacific region, where only 20 per cent of the regional population has access to health-care assistance and out-of-pocket medical expenses are among the highest in the world. In South Asian countries, for instance, only 8 per cent of the population is covered by health-care programmes. While efforts to move towards universal health care coverage need to be intensified in Asia and the Pacific, all countries in the region should increase public expenditure on health care to at least 5 per cent of GDP, as recommended by WHO. Doing so would not require extensive resources.

I. Education for all

57. Education for all is another internationally agreed development goal, adopted at Dakar in 2000.[13] Education is one of the cornerstones of inclusive and sustainable development. More education for women has important impacts on the health of children and contributes to lower reproduction rates, irrespective of a country's level of development; it is also clear that education has a positive effect on health outcomes, earnings and economic growth.

58. Many countries in the region have already achieved universal primary education. However, more efforts to expand primary schooling in the region are needed. An estimated one fifth of the 61 million children of primary school age who are not in school worldwide live in South Asia alone. However, completing primary

[13] See *Final Report of the World Conference on Education for All: Meeting Basic Learning Needs, Jomtien, Thailand, 5-9 March 1990*, Inter-Agency Commission (UNDP, UNESCO, UNICEF, World Bank) for the World Conference on Education for All, New York, 1990, appendix I.

education is no longer sufficient to meet the demands of the increasingly sophisticated labour force that arises as countries develop. Governments must therefore also commit to achieving universal enrolment in secondary education. By increasing public expenditure on primary and secondary education by less than 1 per cent of GDP, most countries in the region would be able to reach these two goals.

J. Energy access for all

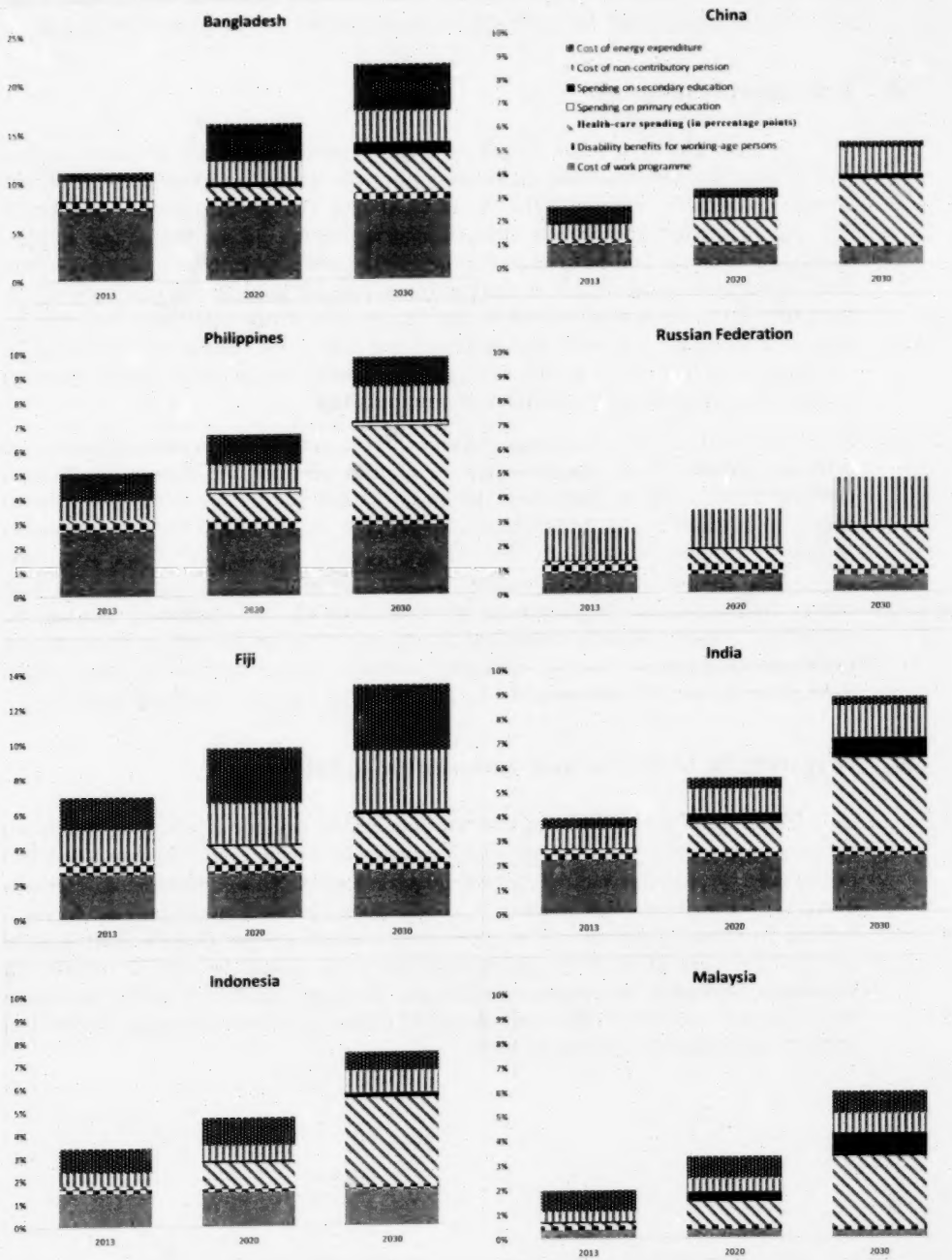
59. To draw global attention to the problems regarding the scale of energy access and to spur the international community towards action, in December 2010, the General Assembly declared 2012 the International Year of Sustainable Energy for All (see resolution 65/151). In the Asia-Pacific region, 1.7 billion people rely on traditional biomass and more than 600 million people live without electricity. More than 70 per cent of the people in the Pacific still do not have access to electricity. At the same time, economic growth in the region is exerting significant pressure on natural resources. National and regional policies must therefore be aimed at designing sectoral policies, especially in the energy sector, that support poverty eradication and promote environmental sustainability.

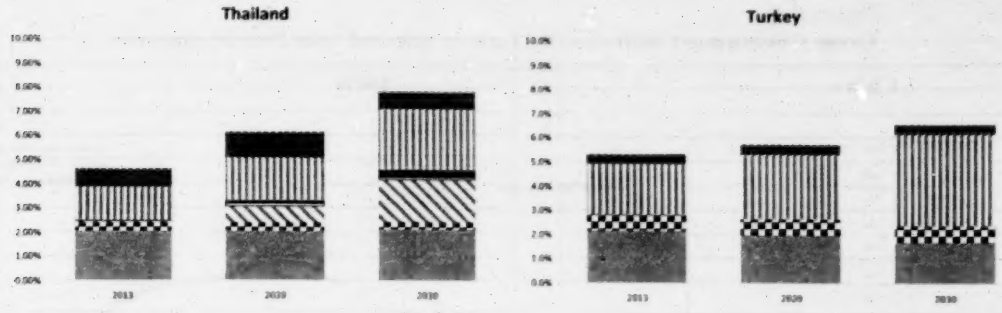
60. Universal access to energy services is essential for increasing economic activities, which create opportunities for employment for all. Burning inefficient cooking fuels, such as traditional biomass, causes indoor air pollution; lack of access to modern cooking fuels therefore poses a severe health hazard. Increasing access to modern, clean and efficient energy is a key driver of inclusive and sustainable development. Governments should address these policy matters through energy policies aimed at improving the efficiency of, and increasing the use of, renewable energy in each country's energy mix. The additional average annual investment required to provide universal access to energy services by 2030 ranges from about a third of 1 per cent of GDP in Turkey to 3 per cent in Bangladesh.

K. Investing in inclusive and sustainable development

61. The overall investment expenditure required to provide a job guarantee to all persons engaged in the informal sector, ensure universal access to education and health-care services, provide disability benefits and an old-age pension, and ensure universal access to modern sources of energy varies between countries (see figure 5 below). In China, requirements are projected to reach 3.3 per cent of GDP in 2020 and 5.2 per cent of GDP by 2030, when all goals would be met. Estimates for Indonesia, Malaysia, the Russian Federation, Thailand and Turkey range between 5 and 8 per cent of GDP; in Bangladesh and Fiji, they would remain under 10 per cent of GDP throughout the period to 2030.

Figure 5
Total expenditure required to provide a job guarantee to informal sector workers in selected Asia-Pacific countries





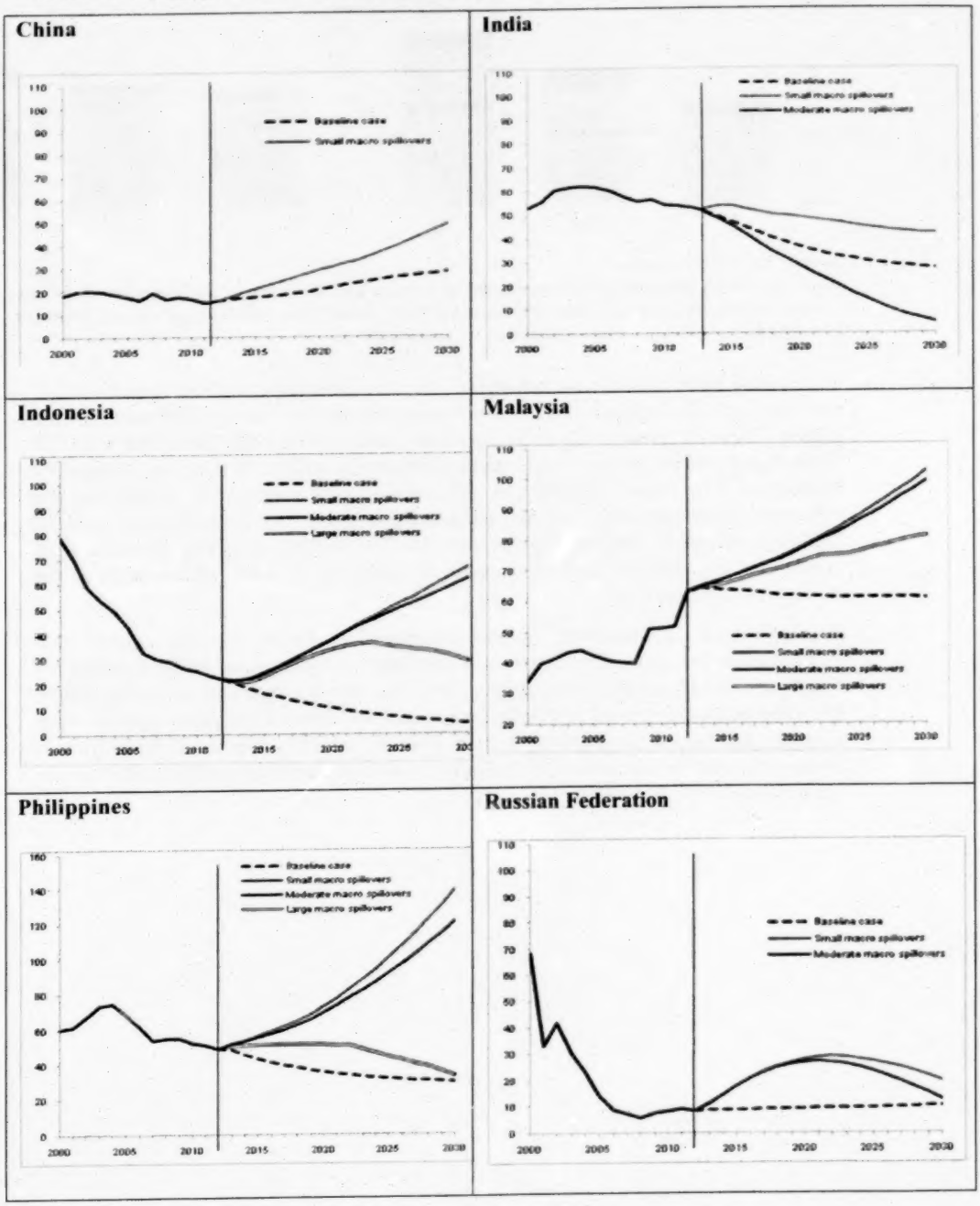
Source: ESCAP calculations.

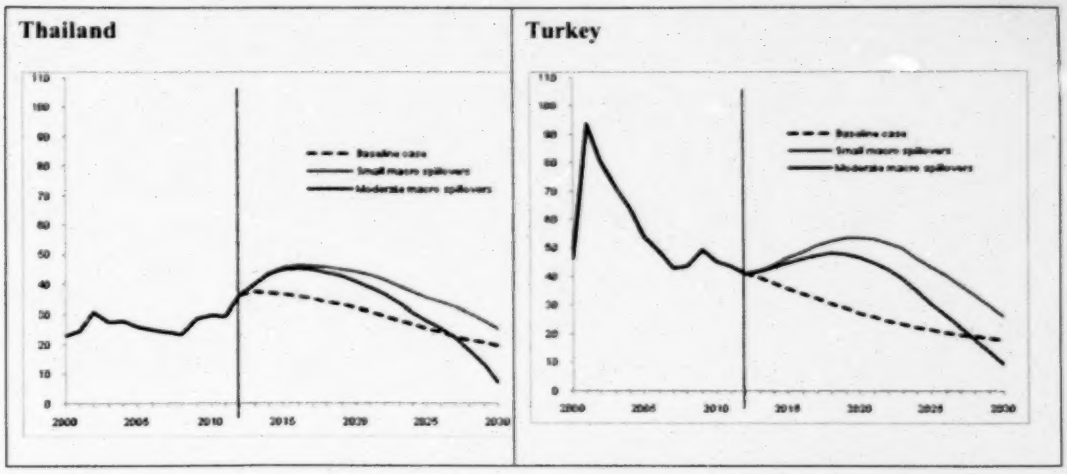
Note: For Turkey, data on public expenditure on primary and secondary school expenditure are unavailable and not included in the graph. Since access to energy is already universal in the Russian Federation, no additional investment and expenditure is required for this indicator.

62. While these amounts are not trivial, they are affordable, especially considering the relatively low expenditure-to-GDP ratios and tax revenue-to-GDP ratios in the region. As such, greater domestic resource mobilization could raise the required financing. Possible options would include enhancing efforts to raise tax revenue by broadening tax bases, making tax structures more progressive, improving the efficiency of tax administration and introducing creative revenue policies to increase available resources. Earmarking tax revenues for socially desirable investment or conducting a campaign, such as "tax for development", would likely improve the incentives for paying tax.

63. Moreover, a long-term macroeconomic simulation exercise shows that Governments can pursue inclusive and sustainable development while maintaining fiscal sustainability and price stability. Thus, the direct impact of additional public spending on output growth and indirect impacts on labour force participation, wage earnings and labour productivity would lead to sustainable future debt paths (see figure 6 below). At the same time, inflation would remain manageable under various simulation scenarios considered.

Figure 6
Gross Government debt-to-GDP ratio in selected Asia-Pacific countries





Source: *ESCAP* calculations, based on the Oxford Global Economic Model.
Note: Baseline cases are projections made by the Oxford model when no shocks are imposed on any variables. The same scale is used in all figures except for that of the Philippines.

64. This is an encouraging finding for countries committed to deliver on their citizens' basic right to development. By doing so, they can at the same time enhance the resilience of their people, improve human security, make development more inclusive and thereby strengthen sustainable development. In sum, investing in health, education, and income and energy security is a win-win solution to both short-term and long-term challenges to resilient, inclusive and sustainable development.

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Latin America and the Caribbean: economic situation and outlook, 2012-2013

Summary

The deterioration in the global economy in 2012 was transmitted to Latin America and the Caribbean mainly through the trade channel. Growth in export values tailed off sharply for the region overall, from 23.9 per cent in 2011 to an estimated 1.6 per cent in 2012. It is estimated that the Latin American countries posted a balance-of-payments current account deficit equivalent to 1.6 per cent of regional gross domestic product (GDP) in 2012, slightly wider than the 1.3 per cent in 2011.

Amid global financial instability, net financial inflows into Latin America and the Caribbean were down heavily. Combined with a larger current account deficit, this led to reserve accumulation of just 50 per cent of the figure for 2011. Net foreign direct investment also shrank, but still remained well above 2010 levels, reflecting the region's attractiveness as an investment destination.

Economic activity in 2012 showed some resilience to external shocks. In particular, the region's rate of GDP growth (3 per cent) exceeded global growth (2.2 per cent).

Consumption remained the leading component of growth in 2012, with investment making a smaller contribution than in 2011.

Employment and wages rose, with unemployment falling more among women than among men, but there are signs that growth in "quality" employment has slowed in some countries. For the region overall the urban unemployment rate declined from 6.7 per cent in 2011 to 6.4 per cent — representing around 15 million people — in 2012.

In most of the countries, monetary policy was geared towards offsetting the negative impact of shrinking external demand on economic activity. Generally speaking, the countries avoided policies, such as interest rate hikes or other types of measure aimed at controlling monetary aggregates, that could choke credit growth

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and domestic demand. Upward pressure on the currencies eased, but exchange rates became more volatile in some countries.

The fiscal position deteriorated in most of the countries, but fiscal policies remained predominantly prudent. With only a few exceptions, the gap between income and expenditure rose in most of the countries, and the spending growth helped to buoy domestic demand.

It is estimated that GDP growth in Latin America and the Caribbean could pick up to around 3.8 per cent in 2013, thanks to brighter prospects in the United States of America and China, higher growth in Argentina and Brazil, and still fairly buoyant domestic demand in several of the region's economies.

In Latin America and the Caribbean, however, the challenge remains of increasing and stabilizing investment growth (rather than relying solely on consumption) to drive structural change, absorb technical progress and achieve suitable growth. In this connection, tapping the regional market within an open regionalism approach could help to offset the weak rendering of external demand in the past few years.

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I. Introduction

1. The global economy slowed significantly in 2012, amid recession in Europe caused by financial, fiscal and competitiveness imbalances, especially in the euro zone, as well as the slowdown in China and moderate growth in the United States of America. Growth rates for output and global trade fell and capital flows to developing countries shrank and became more volatile.

2. The global downturn was transmitted to Latin America and the Caribbean mainly through the trade channel. Growth in export values tailed off sharply for the region overall, from 23.9 per cent in 2011 to an estimated 1.6 per cent in 2012. Falling prices for a large group of export products eroded the value exported and, by contrast with previous years, volume growth was the factor driving the modest increase in the value of exports.

3. Chiefly as a consequence of the deteriorating trade balance, it is estimated that the Latin American countries posted a balance-of-payments current account deficit equivalent to 1.6 per cent of regional gross domestic product (GDP) in 2012, a slight deterioration from the 1.3 per cent in 2011. The deficit on the income account narrowed slightly (from 2.5 per cent to 2.3 per cent of GDP) and current transfers remained stable (at 1.1 per cent of GDP), but this was not enough to prevent the deterioration in the current account position.

4. Amid global financial instability, in 2012 short-term net capital inflows into Latin America and the Caribbean were down from the preceding year. Net financial flows fell heavily with respect to 2011 and this, combined with a larger current account deficit, led to reserve accumulation of just 50 per cent of the figure for 2011. Net foreign direct investment also shrank, but still remained well above 2010 levels, reflecting the region's attractiveness as an investment destination.

5. Economic activity in Latin America and the Caribbean in 2012 showed some resilience to external shocks. In particular, the region' s rate of GDP growth (3 per cent) exceeded global growth (2.2 per cent). Consumption remained the leading component of growth in 2012, with investment making a smaller contribution than in 2011, owing chiefly to the contraction in Argentina and Brazil, which both weigh heavily in the regional average.

6. Employment and wages rose, with unemployment falling more among women than among men, but there are signs that growth in "quality" employment has slowed in some countries. For the region overall the urban unemployment rate declined from 6.7 per cent in 2011 to 6.4 per cent — representing around 15 million people — in 2012. Wage employment continued to grow faster than own-account work (3.1 per cent versus 1.3 per cent).

7. In most of the countries, monetary policy was geared towards offsetting the negative impact of shrinking external demand on economic activity. Generally speaking, the countries avoided policies, such as interest rate hikes or other types of measure aimed at controlling monetary aggregates, that could choke credit growth and domestic demand, despite an uptick in inflation caused in part by the rise in food prices starting in September 2012.

8. The pressure for currency appreciation eased but exchange-rate volatility increased in some countries. The deteriorating current account position and smaller capital inflows into the region meant that the reserves build-up was slower than it

had been in 2011, both as a share of GDP and in absolute terms. Although the exchange rates of countries that are more deeply integrated into international financial markets had followed much the same path in 2011 amid the various shocks that year, the degree of correlation between their movements began to diminish in early 2012.

9. The fiscal position deteriorated in most of the countries, but fiscal policies have remained predominantly prudent. With only a few exceptions, the gap between revenue and expenditure rose in most of the countries as spending rose faster (0.7 percentage points of GDP, on average) than income (0.2 percentage points). This spending growth helped to buoy domestic demand, especially consumption, since in 2012 current spending climbed by 0.4 percentage points of GDP and capital spending by 0.3 percentage points of GDP.

10. The economic outlook for Latin America and the Caribbean depends heavily on how the global economy evolves in 2013. The most likely scenario is very low or flat growth in Europe, some momentum in the United States, and continued growth in China. Taking this as the baseline scenario, it is estimated that GDP growth in Latin America and the Caribbean could pick up to around 3.8 per cent, owing to two effects in particular. First, higher growth in Argentina and Brazil and, second, reasonably buoyant domestic demand in some of the region' s economies, thanks to better labour indicators, a rise in bank lending to the private sector and no further significant falls in commodity prices.

11. However, in Latin America and the Caribbean, the challenge also remains of increasing and stabilizing investment growth (rather than relying solely on consumption) to drive structural change, absorb technical progress and achieve suitable growth. In this connection, tapping the regional market within an open regionalism approach could help to offset the weak rendering of external demand in the past few years.

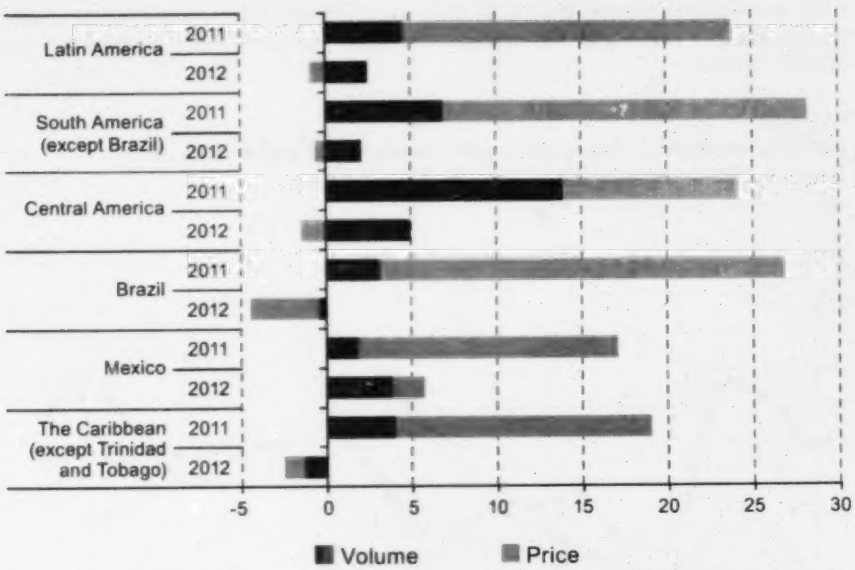
II. External context and its impact on Latin America and the Caribbean

12. Lower growth in the global economy resulted in contraction or lower growth for the region's goods and services exports. The global economy slowed significantly in 2012, amid recession in Europe caused by financial, fiscal and competitiveness imbalances, especially in the euro zone, as well as the slowdown in China and moderate growth in the United States. Growth rates for output and global trade fell and capital flows to developing countries shrank and became more volatile.

13. This deterioration was transmitted to Latin America and the Caribbean mainly through the trade channel. With the European Union in recession and China's economy slowing in 2012, the region's exports to the European Union shrank by 4.9 per cent in value terms and those to China, by 1.7 per cent according to preliminary data. By contrast, exports to the United States increased by 4.8 per cent, thanks to modest growth in that economy, and intraregional exports climbed 1.4 per cent. Growth in export values tailed off sharply for Latin America and the Caribbean overall, from 23.9 per cent in 2011 to an estimated 1.6 per cent in 2012. Falling prices for a large group of goods heavily eroded export values and, in contrast to the

situation in earlier years, higher volumes drove the modest rise in overall export values (see figure I).

Figure I
Latin America: estimated growth in export values, with contribution of volumes and prices, 2011-2012
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

14. The impact was differentiated within the region. Hydrocarbon-exporting countries, together with Mexico and the Central American and Caribbean countries, much of whose goods and services exports go to the United States, felt a smaller impact since many of them increased their exports to that economy and, in some cases, to Europe and China as well. Other South American countries, which ship a larger share of their exports, especially of natural resources, to China and the European Union, suffered a heavier impact, with exports to both destinations falling sharply for some of them.

15. Import prices were less variable than export prices. Volume growth appears to have been much the same for imports as for exports, but generally positive changes in the unit value of imports meant that their total value increased by more than that of exports in 2012. As a result, the surplus on the merchandise trade balance for the region overall narrowed from 1.3 per cent of regional GDP in 2011 to 0.9 per cent in 2012.

16. The services balance also continued to deteriorate in 2012. One of the main reasons appears to have been the increased cost of freight, insurance and other services associated with goods imports (whose volume continued to increase, as noted above). The most negative outcome was in South America. By contrast, the

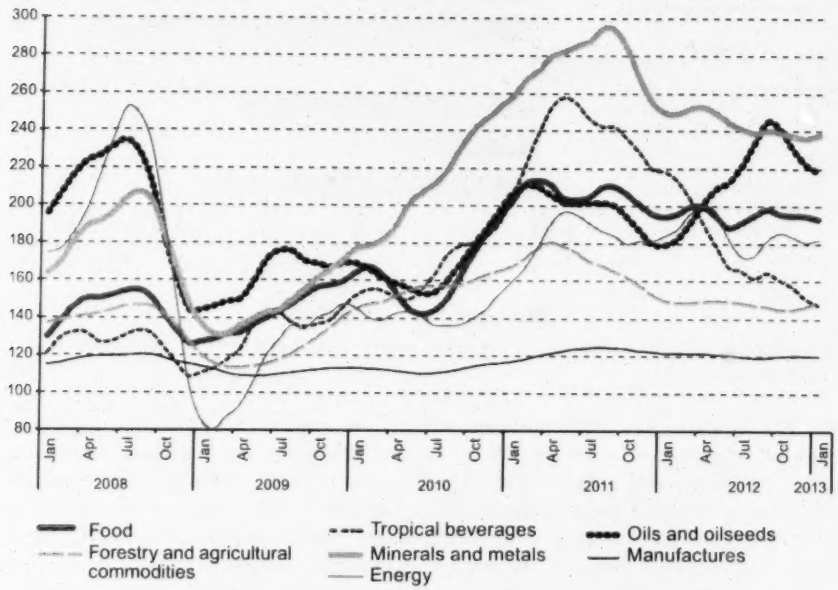
services balance held steady as a share of GDP in the Central American countries and Mexico.

17. Weaker external demand resulted in a slight worsening of the terms of trade. As a result of lower global economic growth, especially in Europe and, to a lesser degree, in Asia, prices for some commodities that account for a large share of the region's export basket trended downward in 2012 (see figure II). In particular, lower demand from emerging and developing economies, particularly in Asia, led to a drop in metal and mineral prices. By contrast, food prices were a partial exception to this trend, as they did not decline but rather fluctuated as a consequence of climatic factors.

Figure II

Latin America: price indices for export commodities and manufactures, January 2008 to January 2013[a]

(Index: 2000=100, three-month moving average)



Source: ECLAC, on the basis of figures from the United Nations Conference on Trade and Development (UNCTAD) and the Netherlands Bureau for Economic Policy Analysis.

[a] The export commodity groups are weighted by their share of Latin American exports.

18. After remaining high in the early months of 2012, the oil price fell back in the second quarter. This tendency was reversed in the third quarter, however, and at year end was very close to its 2011 level. The limited movement of the oil price reflects both a rise in global production (particularly in the Middle East) and a slackening of demand, especially in the euro zone.

19. Given these developments, the region's terms of trade are estimated to have fallen by 2.2 per cent in 2012 (see figure III). For South America, however, a 3.5 per cent decline is estimated, with exporters of mining and metal products (Chile, Peru

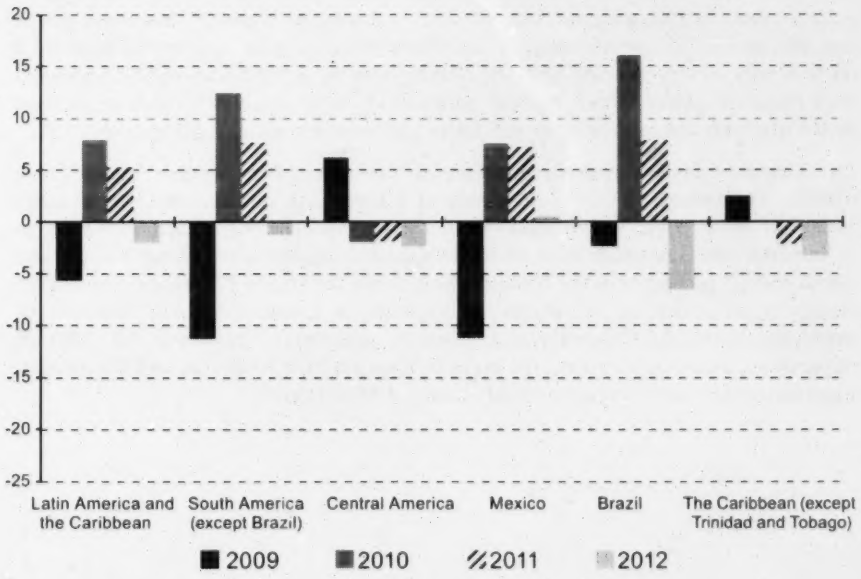
and Brazil) suffering the largest downturn, while the other countries in the region, especially those which export agro-industrial products or hydrocarbons, saw modest terms-of-trade gains.

20. Terms of trade are estimated to have declined by 1.7 per cent for the Central American countries and 3.2 per cent for the Caribbean countries in 2012. The deterioration is attributable to the fall in the prices of the main products exported by these subregions (sugar, coffee and metals). In the case of Mexico, terms of trade improved slightly owing to the fact that its main exports are manufactures.

21. The balance-of-payments current account is estimated to have worsened in most of the countries of the region. Chiefly as a consequence of the deteriorating trade balance, it is estimated that the Latin American countries posted a balance-of-payments current account deficit equivalent to 1.6 per cent of regional GDP in 2012, a slight deterioration from the 1.3 per cent in 2011 (see table). Because of the cooling world economy, the value of exports is estimated to have grown by less (1.6 per cent) than that of imports (4 per cent), with the trade balance thus deteriorating from a surplus of 0.1 per cent of GDP in 2011 to a deficit of 0.4 per cent in 2012.

Figure III
Latin America: estimated variation in the terms of trade, 2009-2012[a]

(Percentages)



Source: ECLAC, on the basis of official figures.

[a] The data for 2012 are estimates.

Table
Latin America: breakdown of the current account, by subregion, 2011-2012[a]
(Percentages of GDP)

	Goods balance		*Services balance*		*Income balance*		*Transfers balance*		*Current account*	
	2011	*2012*	*2011*	*2012*	*2011*	*2012*	*2011*	*2012*	*2011*	*2012*
Latin America	1.3	0.9	-1.2	-1.3	-2.5	-2.3	1.1	1.1	-1.3	-1.6
South America	2.7	2.2	-1.5	-1.6	-2.7	-2.5	0.4	0.4	-1.1	-1.5
Central America	-16.1	-15.5	3.7	3.8	-3.4	-3.6	8.7	8.3	-7.1	-7.0
Mexico	-0.1	0.0	-1.2	-1.2	-1.5	-1.4	2.0	1.9	-0.8	-0.7

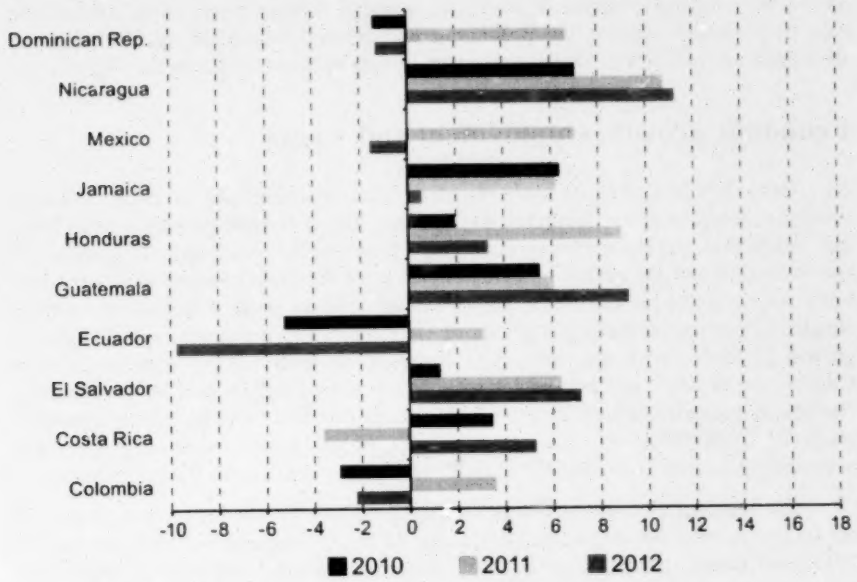
Source: ECLAC, on the basis of official figures.
[a] Data for 2012 are estimates.

22. The main reason for the current account deterioration was a decline in the goods surplus resulting from lower demand for commodities and a terms-of-trade deterioration, particularly for the countries exporting most to the euro zone and China. There were large differences between the region's countries in this respect, however. Chile and Peru appear to have seen a considerably smaller goods trade surplus because of declining exports to Asia and Europe. Brazil's trade deficit rose, as exports fell heavily. By contrast, goods balances appear to have improved in Ecuador and the Plurinational State of Bolivia, owing to higher hydrocarbon prices and an increase in export volumes. Mexico's trade balance appears to have held fairly steady as a proportion of GDP, although its current account deficit narrowed as a result of lower factor income outflows. Central America's current account deficit also appears to have remained fairly unchanged at about 7 per cent of GDP.

23. Current transfers, consisting mainly of remittances from workers abroad, rose slightly. Their share of GDP held steady at 1.1 per cent in 2012, albeit with large variations from country to country (see figure IV). The significant increases in El Salvador and Guatemala were owing to a relative upturn in economic activity and labour market prospects in the United States, while the rise in Nicaragua was chiefly owing to the work of the country's migrants in Costa Rica. The declines in remittance flows to Colombia and Ecuador, meanwhile, reflected the difficult employment situation in Spain, the main destination for Colombian and Ecuadorian migrants, where unemployment stood at around 25 per cent.

Figure IV
Latin America and the Caribbean (10 countries): year-on-year change in emigrant workers' remittances, 2010-2012[a]

(Percentages)



Source: ECLAC, on the basis of official figures.

[a] The rates for 2012 for Costa Rica and Ecuador are up to the third quarter.

24. The deficit on the income account is estimated to have improved slightly in nominal terms, from 2.5 per cent to 2.3 per cent of regional GDP, reversing the downtrend of recent years. This development is linked to the decline in a number of export commodity prices in 2012, resulting in lower earnings for foreign firms operating or investing in the region, with the consequent decline in profit remittances.

25. Amid global financial instability, short-term net capital inflows into Latin America and the Caribbean were down in 2012. Financial flows into the region continued to exceed the current account deficit and refinancing needs, so that international reserves tended to continue to build up, but there were changes from 2011. Net financial inflows were significantly down on the previous year and this, in combination with a larger current account deficit, meant that the reserves build-up was only 50 per cent of that seen in 2011.

26. The drop in net inflows was mainly accounted for by increased outflows in the other net investment liabilities category, which includes the most volatile and shortest-dated components of external financing, and whose evolution partly reflected increased uncertainty in global financial markets. The greatest outflows were from Argentina, the Bolivarian Republic of Venezuela and Mexico, but those from Chile, Colombia, Costa Rica, Guatemala and Uruguay were also substantial.

27. While net foreign direct investment diminished slightly, it remained substantially above 2010 levels, reflecting the region's attractiveness as an investment destination. Lastly, net portfolio investment showed a slight increase over 2011, especially in Mexico. Generally speaking, private-sector bond issues abroad were highly dynamic in 2012, exceeding sovereign issues (which fell in the case of countries such as the Bolivarian Republic of Venezuela, El Salvador, the Dominican Republic and Mexico), despite a small increase in risk in the region.

III. Economic growth, employment and wages

28. Growth was slower in Latin America and the Caribbean in 2012, although several economies maintained their momentum. The economic activity arising from the interaction between global economic deterioration, the regional pattern of specialization and the policy mix implemented by the Governments suggested that Latin America and the Caribbean has continued to show some resilience to external shocks. In particular, the regional rate of GDP growth (3 per cent) exceeded global growth (2.2 per cent), unemployment eased down from 6.9 per cent in 2011 to 6.4 per cent in 2012, and real wages rose. Most of the English- and Dutch-speaking Caribbean countries, which have taken longer to rebound from the global financial crisis of 2008-2009, returned growth rates in 2012 that were still low, but nevertheless positive and slightly up on 2011 (1.1 per cent versus 0.4 per cent).

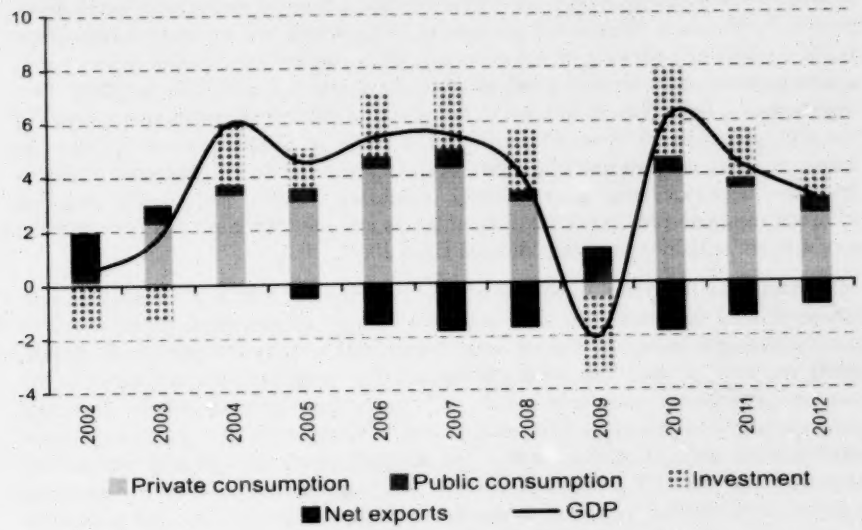
29. The regional performance was heavily weighted by slower growth in two of the largest economies, Argentina (2 per cent in 2012 compared with 8.9 per cent in 2011) and Brazil (0.9 per cent in 2012 compared with 2.7 per cent in 2011). Not including these two countries, the regional GDP rose by 4.4 per cent, which was not far from the rate without those countries in 2011 (4.5 per cent). The economy of Mexico expanded 3.9 per cent and several countries posted rates of 5 per cent or more, including the Bolivarian Republic of Venezuela and Chile (both 5.6 per cent), Costa Rica (5 per cent), Peru (6.3 per cent) and the Plurinational State of Bolivia (5.2 per cent). Panama was again the region's fastest-growing economy (10.7 per cent). The other economies in Latin America and the Caribbean expanded by between 1 per cent and 5 per cent, except for Paraguay, Saint Kitts and Nevis and Jamaica, which registered negative growth. Central America overall achieved growth of 4.2 per cent, South America 2.5 per cent and the Caribbean 1.1 per cent.

30. In aggregate regional terms, economic activity in the region reflected two opposing trends in 2012: the slowdown observed in 2011 continued into the first half of 2012, albeit not with the same intensity in all countries; in the third quarter, however, the regional economy started to pick up, owing in large part to the tenuous recovery in the Brazilian economy.

31. Consumption remained the leading component of growth. With external demand weakening, growth in the region was driven by domestic demand, fuelled partly by monetary or fiscal policy measures in most of the countries (see figure V). The rise in demand was chiefly a reflection of consumption, with public consumption making a larger contribution than in 2011, consistently with the expansion of public spending in many countries. Robust domestic demand partly offset the more sluggish performance of the external sector, whose negative impact was felt more strongly in several South American countries.

Figure V
Latin America: GDP growth and contribution to growth by the components of aggregate demand, 2002-2012[a]

(Percentages based on United States dollars at constant 2005 prices)



Source: ECLAC, on the basis of official figures.
[a] The data for 2012 are estimates.

32. The performance of domestic demand was matched by a rise in domestic economic activity, especially in the services sectors (commerce, restaurants and hotels, and financial and business services) and in construction. Services activities expanded strongly across the board, with all countries recording positive growth. The construction sector recorded double-digit expansion in the Bolivarian Republic of Venezuela, Ecuador, Panama, Peru and Uruguay, unlike the situation in Argentina and Paraguay, where it contracted.

33. Investment made a smaller contribution to growth in 2012 than it had in 2011, owing mainly to the investment contraction in Argentina and Brazil, which both weigh heavily in the regional average. Investment growth was slack, too, in some Central American countries, and in Cuba and the Dominican Republic, with very low investment ratios of around 15 per cent of GDP or less in 2012, although remittances helped to drive expansion of domestic demand. Investment was strongly up in other countries of the region, however, and Latin America and the Caribbean overall achieved an average ratio investment of 22.9 per cent of GDP in 2012, the highest value recorded since 1981. Evidence of stronger growth in construction and commerce suggests that investment went mainly to those sectors and less to procurement of machinery and equipment.

34. At the regional level, loss of momentum in domestic demand meant that real imports of goods and services were less brisk at 4.7 per cent, reflecting more moderate growth in consumption and investment across the region as a whole. Meanwhile, real exports of goods and services expanded by 3.7 per cent. With real

regional imports slowing even more sharply in comparison with 2011, net exports again contributed negatively to growth but less so than in 2011.

35. Employment and wages rose, with unemployment falling more among women than among men, but there are signs that growth in "quality" employment has slowed in some countries. For the region overall, urban unemployment eased down from 6.7 per cent in 2011 to 6.4 per cent in 2012, which was no small achievement in the context of a slowing global economy, but a smaller gain than in recent years: unemployment rates were 8.1 per cent in 2009 and 7.3 per cent in 2010. This represented a reduction of 400,000 in the absolute number of urban unemployed in the region overall, to about 15 million. The drops in unemployment and rises in employment in the past few years have been larger in the South American countries and have been occurring more recently in Mexico. Mexico and Central America have yet to regain pre-2009 employment levels and the Caribbean has not achieved a significant reduction in unemployment since 2009.

36. Based on the simple average of 15 countries for which sex-disaggregated, labour-market information is available, the rise in employment levels occurred mainly among women: the female employment rate rose by 0.4 percentage points, while the rate for men remained unchanged. The long-term upward trend in the female participation rate continued (0.3 percentage points), while the male participation rate diminished in many countries, giving a 0.1 percentage-point reduction on average. Consequently, the unemployment rate among women fell slightly more (by 0.2 percentage points) than the rate for men (0.1 percentage points). Notwithstanding recent advances, disparities between men and women in terms of participation, employment and unemployment continue to be heavily skewed against women.[1]

37. Higher public current spending helped to boost public sector employment in many countries in 2012. Other indicators suggest that improvements are still taking place in the labour market, but at a slower rate than before. Growth in formal wage employment remained strong in several countries, but slowed in Argentina and Brazil in particular, in keeping with slackening economic growth. Growth in wage employment (3.1 per cent) continued to outstrip growth in own-account employment (1.3 per cent). Only in Argentina, the reverse occurred with brisker growth in own-account employment. In most of the countries with data available (7 of 10), the services sector expanded its share in total employment, which reflects slower growth in tradable sectors, such as agriculture and industry, which are harder hit by sluggish external demand.

38. Generally speaking, real wages rose, which helped to bolster domestic demand, particularly consumption. Higher minimum wages in many countries contributed to the rise in real wages at the regional level. In addition, a number of countries made changes to their labour legislation, including measures to give domestic workers stronger rights and better income (Nicaragua, Uruguay and Ecuador), to broaden breastfeeding rights (Bolivarian Republic of Venezuela, Ecuador and Mexico), and to restructure social security contributions to favour labour-intensive activities (Brazil). In Mexico broader legislative changes were made, including the introduction of new types of contract and the regulation of subcontracting.

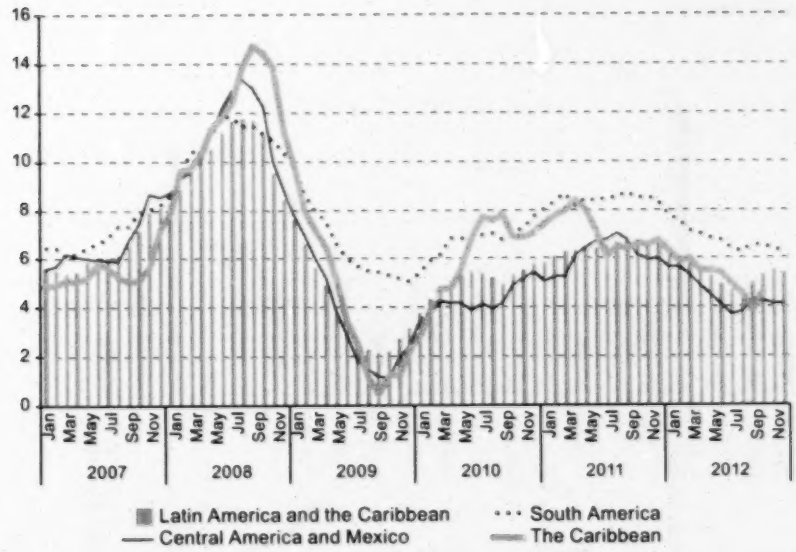
[1] In 2011, the open urban unemployment rate, based on the simple average for 19 Latin American and Caribbean countries, was 6.6 per cent for men and 8.8 per cent for women.

Substantial changes were made in the Bolivarian Republic of Venezuela, as well, with the elimination of outsourcing, a shorter working day and a higher severance pay.

IV. Economic policy responses in Latin America and the Caribbean

39. In most of the countries monetary policy was geared towards offsetting the negative impact of shrinking external demand on economic activity. Generally speaking, the countries avoided policies, such as interest rate hikes or other types of measure aimed at controlling monetary aggregates, that could choke credit growth and domestic demand, despite an uptick in inflation in part by the rise in food prices starting in September 2012. Inflation did temporarily breach the upper limit of the band in countries that run inflation-targeting schemes, such as Mexico and Peru, but the region's unweighted average inflation rate in the 12 months to December 2012 was down to 5.6 per cent, from 6.7 per cent in December 2011 (see figure VI). By subregion, as in 2011, South America posted the highest rate of inflation, and Central America and the Caribbean saw the steepest drops.

Figure VI
Latin America and the Caribbean: 12-month inflation, January 2007 to December 2012
(Percentages)



Source: ECLAC, on the basis of official figures.

40. Liquidity injections by the monetary authorities, as measured by changes in the monetary base, continued to be substantial in 2012, with double-digit growth rates in 17 of the 25 countries for which information is available. Argentina, the

Bolivarian Republic of Venezuela, Peru and Suriname stand out, with annualized growth in the monetary base exceeding 30 per cent. Similarly, the broader monetary aggregates (M1 and M2) expanded in most of the region's countries albeit, as with the monetary base, mostly by less than in 2011.

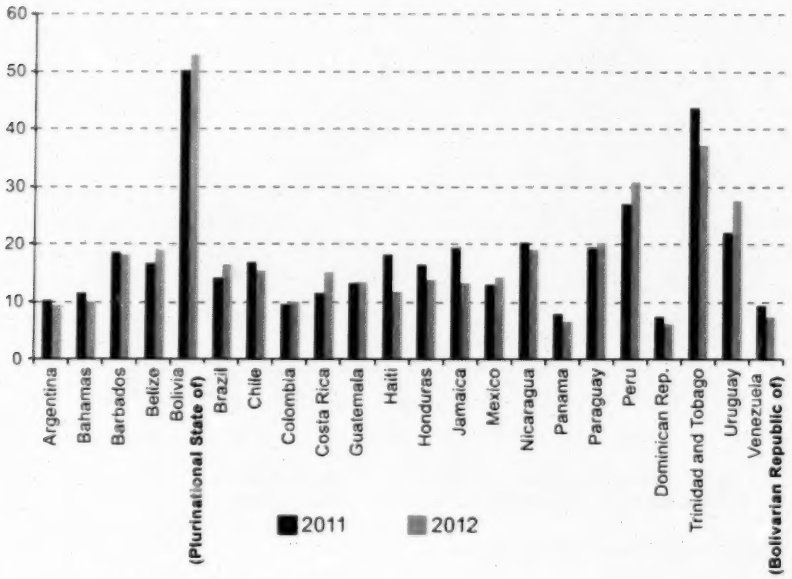
41. Another reflection of the authorities' intentions was the substantial increase in domestic lending during 2012, particularly to the private sector, with growth rates that exceeded 10 per cent in 20 of the 31 countries for which information is available and approached or exceeded 30 per cent in Argentina, the Bolivarian Republic of Venezuela, Guatemala, Haiti and Nicaragua. As regards the sectoral allocation of lending, consumer credit growth was particularly strong at 17 per cent, followed by lending to commerce (13 per cent) and industry (10 per cent).

42. The pressure for currency appreciation eased but exchange-rate volatility increased in Brazil and Mexico. As already noted, the deteriorating current account and smaller capital inflows into the region meant that the reserves build-up was slower than it had been in 2011, both as a share of GDP and in absolute terms. This was heavily influenced by the reduced build-up of reserves in Brazil from the first quarter of 2012. Nevertheless, reserves represented over 25 per cent of GDP in some countries, such as Peru and Uruguay, and over 50 per cent of GDP in the Plurinational State of Bolivia (see figure VII).

Figure VII

Latin America and the Caribbean (selected countries): change in international reserves, December 2011 to December 2012

(Percentages of GDP)



Source: ECLAC, on the basis of official figures.

43. A number of central banks, particularly those of Argentina, Colombia, Costa Rica, Peru and Uruguay, intervened actively in the currency markets. Meanwhile, although Brazil intervened in the currency market and built up reserves only until May 2012, the central bank intervened indirectly in August, September and October by using currency swaps[2] to influence the path of the exchange rate.

44. In Brazil and Mexico, global financial instability exacerbated exchange-rate volatility. Although the exchange rates of countries that are more deeply integrated into international financial markets had followed much the same path in 2011 amid the various shocks that year, the degree of correlation between their movements began to diminish in early 2012 (see figure VIII).

45. The domestic currencies in Brazil and Mexico depreciated in nominal terms against the United States dollar, particularly as expectations about the future path of the European economy deteriorated during the third quarter of 2012.

Figure VIII
Latin America (selected countries): nominal exchange rates against the United States dollar, January 2008 to December 2012
(Index: January 2008=100)

Source: ECLAC, on the basis of official figures.

46. Nominal exchange-rate trends plus the dynamic of inflation in Latin America and the Caribbean led to the region's real effective extraregional exchange rate falling (currency appreciation) by an average of 2.8 per cent during the first 10 months of 2012 as compared to the same period in 2011. The currency

[2] Swaps are a type of financial derivative whereby two parties undertake to swap currencies for a set period of time and at a certain price, with an undertaking to repurchase them at the end of the period. In October 2012, outstanding swap operations were worth $4.9 billion.

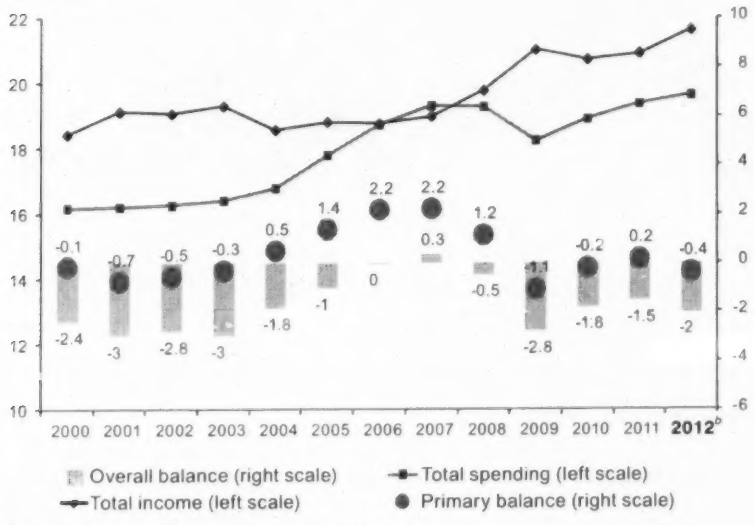
appreciation was greater in South America (4.9 per cent, excluding Brazil) than in Central America (2 per cent), being influenced particularly by falling real effective exchange rates in the Bolivarian Republic of Venezuela, owing to its high inflation and fixed exchange rate. The Caribbean subregion's real effective extraregional exchange rate fell by about as much as that of South America, with the main influence being the currency appreciation in Trinidad and Tobago.

47. Efforts continued to strengthen macroprudential policies through changes to legal reserve requirements, sometimes to promote the use of national currencies (as in Paraguay, Peru, the Plurinational State of Bolivia and Uruguay) or to prevent overborrowing by households (Colombia). Reforms were also made to financial regulations to improve countercyclical provisioning (Ecuador), reduce interest rate risks (Bahamas, Paraguay and Ecuador) or expand central bank powers (Argentina and, to a lesser degree, Guatemala).

48. The fiscal position deteriorated in most of the countries, but fiscal policies have remained predominantly prudent. With only a few exceptions, the gap between revenue and expenditure rose in most of the countries as spending rose faster (0.7 percentage points of GDP) than income (0.2 percentage points). The primary balance (before interest payments) was in deficit by 0.4 GDP points on average, contrasting with a surplus of 0.2 points in 2011. The overall balance (which includes payments of interest on the public debt) yielded a deficit of 2 percentage points of regional GDP (see figure IX).

Figure IX
Latin America (19 countries): central Government fiscal indicators, 2000-2012[a]

(Percentages of GDP)



Source: ECLAC, on the basis of official figures.

[a] Simple averages.

[b] The data for 2012 are estimates.

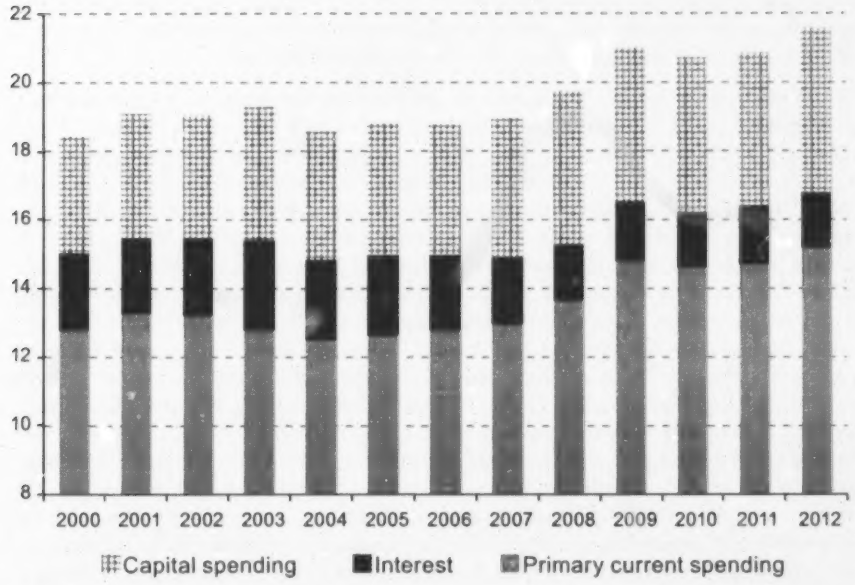
49. The higher spending helped to maintain the momentum of domestic demand, especially consumption, with current spending rising by 0.4 GDP percentage points and capital spending 0.3 GDP points (see figure X). In the case of natural resources exporters, the drop in non-tax income was offset by an equivalent rise in tax income on the strength of buoyant domestic demand but, in countries where revenues increased, the rise was usually quite moderate. Meanwhile, the various tax measures or reforms being pursued in several countries (Chile, Colombia, the Dominican Republic, Ecuador, El Salvador, Guatemala, Panama and Peru) should increase their tax burden in 2013.

50. Debt levels rose only slightly and did not pose a threat to fiscal sustainability in the Latin American countries, where the ratio of central government debt to GDP edged up from 30.5 per cent in 2011 to 31.3 per cent in 2012. The fiscal deterioration was larger in the Caribbean, however, where the overall fiscal deficit widened from 3.6 per cent to 4.0 per cent of GDP. In previous years, raw material-dependent countries, such as Belize, Guyana, Suriname and Trinidad and Tobago, had sustained a better financial and fiscal performance, but this deteriorated sharply in 2012. Service economies such as Antigua and Barbuda, the Bahamas, Barbados and Jamaica have been badly affected by the drop in revenues from tourism and offshore financial services since the start of the international financial crisis and continued to feel these effects in 2012. Thus, public debt in Barbados and Jamaica rose to 106 per cent and 128 per cent, respectively, of GDP in 2012.

Figure X

Latin America (19 countries): central Government expenditure, 2000-2012[a]

(Percentages of GDP)



Source: ECLAC, on the basis of official figures.

[a] The data for 2012 are estimates.

V. Outlook and challenges

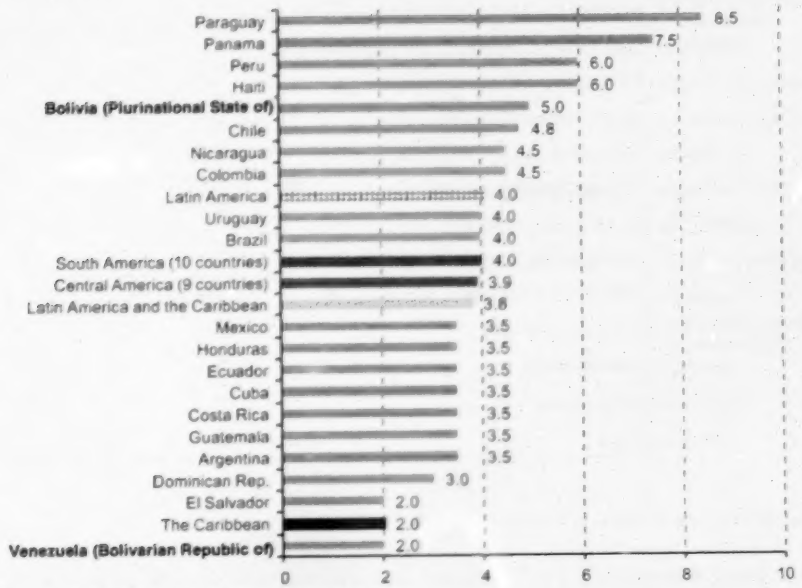
51. The economic outlook for Latin America and the Caribbean depends heavily on how the global economy evolves in 2013. The most likely scenario is continued low growth in Europe and even recession in some European countries. The crisis in the euro zone is still one of the main risk factors for Latin America and for the global economy in general. The situation in Europe has prevented consensus on whether the way out of the crisis lies in fiscal austerity and structural reform, or in policies for kick-starting growth. All the signs are that efforts will be geared towards tackling specific situations, providing the liquidity and financial assistance to help stricken economies through critical episodes and promoting very gradual structural reform (that is, the approach that has been dubbed "muddle-through").

52. Meanwhile, the United States has achieved only a partial fiscal accord and although the cap on public borrowing has been staved off for the moment, the failure to agree on long-term solutions has triggered the automatic spending cuts (the "sequester") specified in the 2011 budget. These cuts will likely erode growth, but are not large enough to push the economy into recession. If, as appears likely, agreement can be reached in the course of the year to moderate these adjustments, the economy should remain on a positive, albeit shallow, growth track. The Federal Reserve has also confirmed its intention to maintain an expansionary monetary policy stance. With employment and housing indicators favourable as well, growth projections for the United States economy are on the order of 1.7 per cent for 2013. China's rate of growth may rise — or at least should not fall — in 2013, depending on how much the country can boost domestic consumption while holding down inflation and regaining export growth. However, China may find it hard to boost its exports if a fiscal pact remains elusive in the United States or Europe's economy performs worse than in 2012. The scenario described also assumes that oil will not become a factor of additional instability for geopolitical reasons.

53. Taking the most likely scenario as the baseline for 2013, it is estimated that GDP growth in Latin America and the Caribbean could pick up to around 3.8 per cent (see figure XI), owing to two effects in particular. First, higher growth in Argentina and Brazil, on the back of recovery in the agricultural sector in Argentina and in manufacturing and investment in Brazil. An upswing in trade between the two countries could also boost their respective economic activity levels. Second, several of the region's economies are expected to experience strong domestic demand thanks to improvements in labour indicators and an increase in bank lending to the private sector. Slack demand and uncertain conditions in the external sector could lead to falls in raw material prices, although these will remain high by historical standards. With external demand contributing little to economic growth amid sluggish global growth and domestic demand remaining buoyant, the current account deficit will widen somewhat in 2013. This is unlikely to herald external financing difficulties, however, for three reasons. First, most of the region's countries are holding ample international reserves. Second, public foreign borrowing levels are low, except in a few Caribbean countries. Given also the external assets built up by a number of countries, the region overall appears to be well placed to meet its external obligations with ease. Third, Latin America and the Caribbean is offering a better risk profile than other regions at present and, with just a few exceptions, will continue to be an attractive destination for foreign direct investment. In addition, its

risk ratings will very likely continue to improve in 2013, so steady financial flows in 2013 should be sufficient to cover any external liquidity needs.

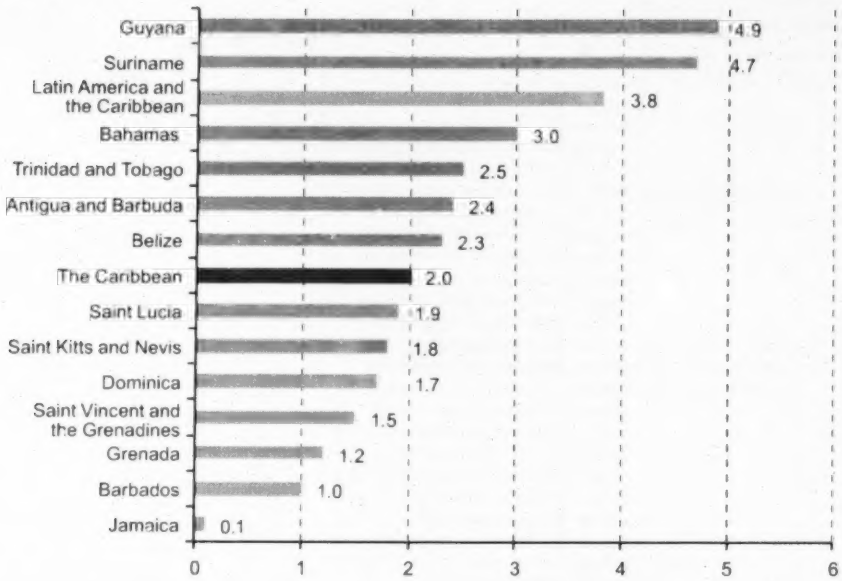
Figure XI
Latin America and the Caribbean: GDP growth forecasts, 2013
(Percentages)



Source: ECLAC, on the basis of official figures.

54. In this scenario, growth rates should be less disparate in 2013, including an uptick in the Caribbean subregion from 1.1 per cent in 2012 to 2.0 per cent (see figure XII). However, the Caribbean countries are still on a fragile fiscal footing and need fiscal reform along with external support to firmly gain sustainable fiscal consolidation paths.

Figure XII
The Caribbean: GDP growth forecasts, 2013
(Percentages)



Source: ECLAC, on the basis of official figures.

55. In Latin America and the Caribbean, the challenge also remains of increasing and stabilizing investment growth (rather than relying solely on consumption) to drive structural change, absorb technical progress and achieve suitable growth. In this connection, tapping the regional market within an open regionalism approach could help to offset the weak rendering of external demand in the past few years.

56. Lastly, although it is less likely than the baseline scenario, a lower growth scenario cannot be ruled out, given the (albeit receding) possibility that external risk factors — the deepening of the crisis in the euro zone, lack of agreement over how to deal with the fiscal situation in the United States, a heavy slowdown in China or oil price hikes fuelled by political tensions in the Middle East — will worsen. In that case, the resilience the Latin American and Caribbean region has shown thus far would be more severely tested and the impact would continue to be uneven in the region, depending on the significance of each of these factors for the economies of the individual countries. A growth slowdown in the United States would affect Mexico, Central America and the Caribbean the most, whereas the South American countries would feel the impacts more heavily if Europe remained in recession or China's economy cooled. Finally, an oil price hike could have a more or less favourable impact, depending on the countries' positions as net exporters or importers of fuels.

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Regional cooperation

Summary of the survey of economic and social developments in the Economic and Social Commission for Western Asia region, 2012-2013*

Summary

The average growth rate of gross domestic product (GDP) of the Arab region in real terms is estimated to be 4.8 per cent in 2012, compared with 2.2 per cent in 2011. The recovery in the Maghreb subregion, in particular Libya, contributed to the region's growth, as well as to the consistent growth in Gulf Cooperation Council (GCC) countries. For 2013, the average real GDP growth rate of the region is projected at 4.4 per cent. The GDP growth rate, on average, is likely to taper off owing to the decline in energy export revenues, which marked a historical high in 2012. However, the region's economic and social developments became further polarized in 2012. Major energy exporters in the region, namely the GCC member countries, have been on a stable recovery path as a result of the expansionary fiscal and monetary policy mix. At the same time, net energy-importing countries in the region struggled to stabilize their economies amid worsening foreign exchange constraints. The polarization was partly due to political instability and social unrest, as well as to the severed intraregional flow of funds in trade, tourism and investments. The lack of confidence in intraregional business transactions resulted in the segmentation of the regional economies. The loss of regional leverage caused by the segmentation, in turn, amplified the seriousness of the unemployment issue

* After Libya, Morocco and Tunisia became member countries of the Commission in July 2012, it was decided that the territorial coverage of the survey of economic and social developments in the region would be expanded to include all of the countries that constitute the Arab region. The following subregional grouping is used in the present document, taking into account a combination of per capita income levels, geographical proximity and similarities in economic and social characteristics and conditions: Gulf Cooperation Council (GCC) countries (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, United Arab Emirates); Mashreq (Egypt, Iraq, Jordan, Lebanon, Syrian Arab Republic, State of Palestine); Maghreb (Algeria, Libya, Morocco, Tunisia); and Arab least developed countries (Comoros, Djibouti, Mauritania, Somalia, Sudan, Yemen).

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throughout the region, even in GCC countries. Amid these economic and employment difficulties, social development in the region has continued gradually through a series of policy reforms and institutional development. Most notably, in 2012 Saudi Arabia adopted a series of active labour policies for Saudi nationals, emphasizing the importance of female employment. However, much of the social dynamics in the region was characterized by social unrest in parallel with political instability. The structural weakness of the economies in the Arab region, represented by high unemployment rates and income inequalities, is the chronic undercurrent of motivation for social unrest and political instability. Reviving effective regional leverage through further regional cooperation and integration efforts is crucial to compensate for the failing market-based intraregional resource transfers.

I. Global context

1. The world economy continued to struggle to recover throughout 2012. The global financial crisis of 2008-2009 led central banks in the developed economies to take a monetary easing stance to its maximum. A series of monetary policy coordination efforts in line with this has successfully contained the contagion of a liquidity crisis. Moreover, fiscal stimulus policies adopted at the global level in 2008 and 2009 successfully buoyed global demand growth from the risk of serious implosion. The possibility of the world economy being trapped in a deflationary spiral was clearly averted. However, despite those short-term successes, the struggle for stable economic recovery became more apparent in 2012 as economic policy options for many Governments were exhausted further. The quickly shrinking fiscal space forced many Governments to maintain a fiscal austerity stance. Meanwhile, the speed of balance sheet adjustment of the financial sector, which was hit by the global financial crisis of 2008-2009, varied: while a smooth adjustment has been observed in the United States of America, the process has been slow in the euro area. The remaining uncertainty over financial risks, which could still be contagious, precluded a strong investment-led growth recovery of the world economy at this stage. The developed economies, particularly in Europe, are still prone to a double-dip recession.

2. The developing economies, including member countries of the Economic and Social Commission for Western Asia (ESCWA) in the Arab region, increased their presence in the world economy in 2012 by sustaining the world economy's demand growth. However, it appeared that the economic performance of developing economies was diverging according to their resource endowments. This was mainly due to the stagnating global investment flows as the investors stayed cautious in taking risks. Therefore, those developing economies with natural and financial resources could weather the uncertain world economic situation. Such resilience on the part of developing economies has sustained the world's demand for natural resources, compensating for the moderately decreasing demand from the developed economies. However, the developing economies without natural resource endowments have suffered increasingly from the rising foreign exchange constraint, as the capital inflow to those economies became insufficient to finance the current account deficits. The international price of food and energy stayed relatively stable in 2012, but some developing economies experienced high inflation rates due to country-specific factors which are mainly related to foreign exchange constraints.

3. With regard to the immediate prospects for 2013, the sustainability of sovereign debts, in both developed and developing countries, casts a shadow of vulnerability on the world economy. This vulnerability points to two issues of concern. First, the balance sheet adjustments of the financial sector have not been completed in many economies. The financial sector's asset side of the balance sheets suffered from the global financial crisis of 2008-2009. The recovery of asset prices has been slow and mostly still below pre-crisis levels. The Governments' fiscal intervention was intended to support the financial sector's balance sheet adjustments directly and indirectly, but such intervention turned out to be unsustainable in several countries, particularly in Southern Europe. The most recent case in point was the financial insolvency crisis in Cyprus, for which the national Government could not sustain its fiscal support. As long as asset prices are stagnant, the world economic situation maintains this fundamental fragility from the ongoing

slow balance sheet adjustment of the financial sector. Second, with the exception of those countries with natural resources, more Governments maintained their fiscal austerity stance during the 2012-2013 fiscal years. Moreover, it is expected that more central banks are shifting to a tighter monetary stance in 2013. This general trend towards a tightening policy mix is being justified as fiscal prudence and a measure against an expected rise in inflation. However, the policy tightening may negatively affect still-progressing balance sheet adjustments in the financial sector in most of the developed economies.

4. The fragility of the world economic recovery was also reflected in its extremely weak employment creation. The situation did not improve in the developed economies in 2012, which resulted in multiple negative effects on the developing economies' employment opportunities as job seekers in the developing economies suffered from the loss of opportunities to obtain jobs by migration, in addition to chronic high unemployment in their home countries. The employment situation has crucial financial implications for the developing economies as workers' remittances became an even more vital source to finance current account deficits. In sum, the main challenges that the world economy is facing consist of: (a) smooth balance sheet adjustment in parallel with the recovery of asset prices at the global level; (b) appropriate growth-leaning macroeconomic policy mix to revive the financial sector; and (c) sufficient employment creation, as the issue of rising unemployment, in both the developed and developing economies, will be the most crucial for solid economic recovery.

5. In this global context, ESCWA member countries of the Arab region exhibited further polarization in their development paths in 2012. Major energy exporters in the region, namely the member countries of the Gulf Cooperation Council (GCC), have been on a stable recovery path as a result of the expansionary fiscal and monetary policy mix. At the same time, net energy-importing countries in the region struggled to stabilize their economies amid the worsening foreign exchange constraint. The polarization was partly due to political instability and social unrest, as well as the severed intraregional flow of funds from the region's major energy exporters. The lack of confidence in intraregional business transactions resulted in the segmentation of the regional economies. The loss of regional leverage caused by the segmentation, in turn, amplified the seriousness of the unemployment issue throughout the region, including in GCC countries. Amid these economic and employment difficulties, social development in the region has continued gradually through a series of policy reforms and institutional development. However, much of the social dynamics in the region was characterized by social unrest in parallel with political instability.

II. Oil sector development

6. According to estimates from the Organization of the Petroleum Exporting Countries (OPEC),[1] the total world oil demand in 2012 averaged 88.8 million barrels per day, while the total supply of crude oil averaged 89.8 million barrels per day. The demand for crude oil is estimated to have increased in 2012 by 0.8 million barrels per day over the previous year. The declining trend in the demand from the developed economies continued, while the demand from

[1] OPEC monthly oil market report, February 2013.

developing economies has consistently grown, with China remaining the main contributor of oil demand growth. From the near-maximum level of crude oil production, OPEC member countries have been reducing production gradually since August 2012. Meanwhile, the crude production of the United States and Canada has shown a notable increase through the development of shale/tight oils and tar sands extractions. Geopolitical risks associated with crude oil supply are expected to remain, but the world crude oil supply is expected to have a sufficient level of spare capacity for 2013. With a view to relaxing the supply/demand balance, OPEC may moderately reduce the production quota in 2013.

7. Crude oil prices experienced a rapid decline in the first half of 2012 owing mainly to the concern over the world demand growth. However, prices recovered throughout the second half of the year to mark the historically high annual average. The OPEC reference basket price averaged $109.45 per barrel in 2012, which marked the year's highest at $124.64 per barrel on 8 March and the lowest at $88.74 per barrel on 22 June (see table 1). Speculations in commodity futures markets remained influential in both selling and buying. Financing for speculators remained available with the prolonged monetary easing policies in the developed economies, where nominal interbank interest rates stayed at a historical low. For 2013, the prospects of crude oil prices, as well as the price of fuel products, are increasingly dependent on the extent of a potential supply glut in the global market of fuel products. The weak recovery of the world economy continues to be the main concern. Moreover, North American refiners have been gaining competitiveness owing to the increasing production of shale oil, which pressured the refining margins in Asia and Europe. Overcapacity in the oil tanker market is another factor that lowered the price of crude oil and fuel products. As several other asset classes showed signs of recovery, speculations are expected to be relatively less influential. Having taken these factors into consideration, the average OPEC reference basket price for 2013 is projected to average between $85.00 and $120.00 per barrel.

Table 1
Crude oil price estimation and forecast, 2010-2013
(OPEC reference basket, United States dollars per barrel)

Year	*Minimum*	*Maximum*	*Annual average*	*Forecasted annual average for 2013*		
				Lower	*Median*	*Higher*
2010	66.84	90.73	77.45			
2011	89.81	120.91	107.46			
2012	88.74	124.64	109.45			
2013				85.00	102.50	120.00

Source: OPEC for 2010-2012. Figures for 2013 are forecasts as at March 2013.

8. The total crude oil production of the region's major energy exporters, namely the GCC countries, is estimated to have averaged 16.8 million barrels per day in 2012, increasing by 4.2 per cent from the previous year. Total production reached a record high, surpassing the level of 2008. Iraq continued to expand its production capacity; its crude oil production grew by 11 per cent to an average of 2.9 million barrels per day in 2012. The crude oil production of Libya saw a rapid recovery from a drastic production plunge in 2011. Its crude oil production has grown to an

average of 1.3 million barrels per day, which is at 89 per cent of the 2010 level. Transport difficulties related to the worsening security situations in the Sudan and the Syrian Arab Republic seriously reduced crude oil production and exports from those countries. Yemen managed to maintain the export level of the previous year despite occasional disruptions to crude oil transport through pipelines.

III. Regional economic trends

9. The real growth in gross domestic product (GDP), on average, in the Arab region is estimated at 4.8 per cent in 2012, compared with 2.2 per cent in 2011 (see table 2). The recovery in Maghreb economies, in particular Libya, contributed to the improvement in the average growth rate, as well as to consistent growth in GCC economies. However, the region's economies became further polarized in 2012. The polarization was partly due to political instability, social unrest and armed conflicts, as well as the severed intraregional flow of funds from the region's major energy exporters. While major energy-exporting countries in the region recorded another year of high energy export revenues, energy importers in the region struggled to finance their current account deficits. The weak demand of European economies for non-energy exports from the region and hovering energy prices also contributed to the widening current account deficits of energy-importing countries in the region. The high oil prices, combined with near-maximum output levels, resulted in another historical high in energy export revenues for major energy exporters in the region. However, the positive cross-border spillover of energy export revenues was observed to be limited within GCC countries; other subregions in the Arab region have not benefited from the present "oil boom". The failing intraregional markets led to a segmentation of the region's economies.

Table 2
Real GDP growth rate and consumer price inflation rate, 2009-2013
(Percentage)

	Real GDP growth rate					*Consumer inflation rate*				
Country/area	*2009*	*2010*	*2011*[a]	*2012*[b]	*2013*[c]	*2009*	*2010*	*2011*	*2012*[b]	*2013*[c]
Bahrain	2.5	4.3	1.9	3.4	3.0	2.8	2.0	-0.4	2.8	3.2
Kuwait	-7.1	-2.4	6.3	4.7	3.2	4.0	4.0	4.8	2.9	3.2
Oman	3.3	5.6	0.3	6.5	4.0	3.2	3.2	4.1	2.9	3.2
Qatar	12.0	16.6	13.5	6.2	5.2	-4.9	-2.4	1.9	1.9	2.5
Saudi Arabia	0.1	5.1	7.1	6.8	5.5	4.1	3.8	3.7	2.9	3.0
United Arab Emirates	-4.8	1.3	4.2	4.0	3.8	1.6	0.9	0.9	0.7	2.0
GCC countries[d]	**-0.7**	**4.6**	**6.6**	**5.7**	**4.7**	**2.7**	**2.6**	**2.9**	**2.2**	**3.7**
Egypt[e]	4.7	5.1	1.9	2.2	3.2	11.8	11.3	10.1	7.2	11.0
Iraq	5.8	5.9	8.6	11.3	7.8	-2.8	2.4	5.6	6.1	6.0
Jordan	5.5	2.3	2.6	2.7	2.9	-0.7	5.0	4.4	4.8	5.0
Lebanon	8.5	7.0	1.5[b]	1.2	1.8	1.2	4.0	4.9	6.6	5.2
Syrian Arab Republic	5.9	3.4	-2.0[b]	-31.4	-7.1	2.8	4.4	4.7	36.5	12.0

Country/area	Real GDP growth rate					Consumer inflation rate				
	2009	2010	2011[a]	2012[b]	2013[c]	2009	2010	2011	2012[b]	2013[c]
State of Palestine	7.4	9.3	12.2	5.3	4.0	2.8	3.7	2.9	2.7	3.0
Mashreq[d]	**5.6**	**5.1**	**2.2**	**-1.7**	**2.6**	**6.5**	**7.7**	**7.6**	**11.4**	**9.3**
Algeria	2.4	3.3	2.9	2.8	2.9	5.7	3.9	4.5	8.6	4.8
Libya	-0.7	4.2	-61.3	100.7	15.0	2.5	2.5	15.0	5.0	3.5
Morocco	4.8	3.7	5.0	2.8	4.9	1.0	1.0	0.9	1.3	1.8
Tunisia	3.1	3.2	-1.9	2.6	3.6	3.5	4.4	3.6	5.6	5.2
Maghreb[d]	**2.5**	**3.6**	**-9.3**	**10.6**	**5.3**	**3.6**	**3.0**	**5.5**	**5.7**	**3.9**
Comoros	1.8	2.1	2.2	2.5	3.5	4.8	4.2	6.8	5.0	3.2
Djibouti	5.0	3.5	4.8	4.7	4.8	1.7	4.0	6.8	5.0	3.2
Mauritania	0.1	5.6	5.1	4.8	6.3	2.2	6.3	5.7	6.2	6.0
Somalia	–	–	–	–	–	–	–	–	–	–
Sudan	5.9	5.2	2.7[b]	-7.0	2.5	11.2	13.0	18.1	35.1	22.0
Yemen	4.3	6.8	-15.3[b]	-1.0	4.5	5.4	11.1	19.4	10.2	9.5
Arab least developed countries[d]	**5.1**	**5.5**	**-2.3**	**-4.6**	**3.2**	**9.5**	**11.6**	**17.2**	**24.6**	**16.5**
Total, Arab region[d]	**1.3**	**4.5**	**2.2**	**4.8**	**4.4**	**3.9**	**3.9**	**4.9**	**5.5**	**4.8**

Source: National sources, unless otherwise stated.

[a] Preliminary figures (subject to revision).

[b] March 2013 estimates.

[c] March 2013 forecasts.

[d] Figures for country groups are weighted averages, based on GDP at 2005 constant prices.

[e] Figures for Egypt are for the fiscal year, which ends in June.

10. GCC countries, on average, are estimated to have experienced a 5.7 per cent GDP growth rate in 2012, after registering 6.6 per cent in 2011. Despite the deceleration in the growth rate, GCC economies showed more robustness, with consistent domestic demand growth. With the exception of Saudi Arabia, the consequence of the global financial crisis of 2008-2009 of most concern was an implosion of domestic demand and debt deflation. Favourable external economic conditions, such as the recovery of energy prices and international coordination in monetary easing, favourably influenced the economic sentiment and confidence in GCC countries. The financial sector's balance sheet adjustment in the subregion progressed smoothly despite the fact that the price level of both financial and property assets has not yet recovered to pre-crisis levels. Saudi Arabia led the economic recovery in the subregion, its economy continuing to experience stable domestic demand-led growth supported by an expansionary fiscal and monetary policy mix.

11. For 2013, GCC countries are expected to continue to experience stable economic growth, although the GDP growth rate on average is likely to taper off. The deceleration of the growth rate is mostly caused by an expected decrease in energy export revenues, as both crude oil production and prices are expected to

decline moderately. However, strong domestic demand growth is expected throughout GCC countries, as is the recovery of the financial sector's balance sheet. The continuing efforts to diversify the energy production-based economies with institutional reforms, targeting foreign direct investments, further create growth potential in the subregion. The average real GDP growth rate of the subregion is projected at 4.7 per cent for 2013. The economic growth rates of GCC countries are projected to show a converging trend, with the exception of Kuwait, where domestic demand growth remains relatively weak as a result of slower non-energy sector growth. In other GCC countries, however, the structural fragility in domestic demand is likely to be offset by active fiscal policy and project implementation in the non-energy sector. In 2013, the forecasted growth rate is 3.0 per cent for Bahrain, 3.2 per cent for Kuwait, 4.0 per cent for Oman, 5.2 per cent for Qatar, 5.5 per cent for Saudi Arabia and 3.8 per cent for the United Arab Emirates.

12. The economies in the Arab Mashreq subregion are, on average, estimated to have contracted by 1.7 per cent in 2012, after registering 2.2 per cent growth in 2011. The devastation of the Syrian economy was the largest factor to influence the subregion's economic contraction. The subregion was most affected by political instability and social unrest and the economic repercussion of the Syrian crisis. The slump in non-energy exports and the higher cost of energy imports widened the current account deficits. Moreover, the weakened capital inflows into the subregion from GCC countries and Europe made it difficult to finance such external deficits. Tourism, which has been one of the main economic activities driving domestic demand growth in Arab Mashreq economies, was substantially affected by security warnings of various extents, which deterred tourists from visiting the subregion. Construction activities, another pivotal source of domestic demand expansion, have also slowed down. Meanwhile, industrial development in the subregion marked a significant setback, particularly in the Syrian Arab Republic. The production factories and facilities in the Syrian industrial zones were severely damaged by the armed conflicts. The real GDP growth of Iraq was mainly due to a special factor of crude oil production expansion, which did not correspond to the slow domestic income growth. The real GDP growth of the State of Palestine was also based on a scaling effect in the ongoing reconstruction of the economy in the Gaza Strip. The physical blockades and continuing security instabilities and hostilities continued to be a severe constraint on the Palestinian economy.

13. For 2013, the Arab Mashreq subregion is projected to experience moderate recovery, at 2.6 per cent on average. This figure is highly influenced by the increasing crude oil production of Iraq and other energy-related activities in the subregion. As no resolution of the deteriorating security situation, particularly in the Syrian Arab Republic, is in sight, business confidence and consumer sentiment are expected to remain weak in 2013 in the subregion. Moreover, the capital account position is expected to remain weak, and the risk of further balance of payments difficulties remains. The space for domestic demand growth remains limited on both the supply and demand side factors. Fiscal austerity is expected to continue in Egypt, Jordan and Lebanon, and a tighter monetary policy stance is likely in Egypt and Jordan in order to defend their respective national currencies. Resource flows in the form of official development aid are expected to be crucial for the subregion to release fiscal and foreign exchange constraints. In 2013, the forecasted growth rate is 3.2 per cent for Egypt, 7.8 per cent for Iraq, 2.9 per cent for Jordan, 1.8 per cent

for Lebanon and 4.0 per cent for the State of Palestine. The economy of the Syrian Arab Republic is projected to contract further by 7.1 per cent.

14. The economies in the Maghreb subregion are, on average, estimated to have grown by 10.6 per cent in 2012, after registering a 9.3 per cent contraction in 2011. The major contributor to the subregion's economic expansion was the resumption of energy production in Libya after it collapsed in the previous year. Even with this phenomenal rate of growth, the Libyan economy has not reached its 2010 pre-crisis levels. Meanwhile, the economy of Morocco was affected by an underperforming agricultural sector owing to poor weather conditions. Despite the increasing number of social unrest and security incidents, the subregion exhibited resilience to mark moderate growth. With regard to Algeria, stable energy export revenues were sufficient to cushion the negative economic and non-economic impacts. The availability of international finance for Morocco and Tunisia to fill the gap of external deficits kept foreign exchange constraints from becoming binding. The moderate domestic demand expansion was commonly observed in the subregion. However, growth was considerably insufficient to create decent employment opportunities, particularly for young job seekers.

15. For 2013, the Arab Maghreb subregion is projected to continue to grow by 5.3 per cent. With this rate of growth, the subregion is expected to surpass the pre-transition levels of 2010. In spite of social unrest in several cities and the neighbouring countries, the Arab Maghreb countries are well situated to receive foreign direct investments and international aid, and the subregion's business environment is increasingly perceived to be less risky than that of the Arab Mashreq. The uncertainty concerning the investment environment is gradually lifted. This is particularly the case in the energy-exporting countries of Algeria and Libya, and the potential of Morocco and Tunisia may be re-evaluated by foreign investors if the sovereign debt crisis situation in the euro area continues. However, the structural fragility of the subregion's economy remains, owing to its weak export-oriented non-energy production base. More decent employment opportunities are urgently needed to resolve the fundamental cause of social unrest in the subregion. In 2013, the forecasted growth rate is 2.9 per cent for Algeria, 15.0 per cent for Libya, 4.9 per cent for Morocco and 3.6 per cent for Tunisia.

16. The economies of Arab least developed countries are, on average, estimated to have contracted by 4.6 per cent in 2012, following the previous year's contraction of 2.3 per cent. The average contraction was mainly contributed by that of the Sudan and Yemen. The struggle of the Sudan for economic stability continued after the separation of South Sudan. A number of armed conflicts over the border area early in 2012 made it difficult for the Sudan to adjust smoothly to the new economic environment. However, as South Sudan and the Sudan finally reached an agreement over the terms of oil production and transportation in March 2013, external economic and non-economic environments are expected to stabilize. Owing to the loss of crude oil export revenues, the Sudan suffered from a serious foreign exchange constraint, which negatively affected the country's domestic demand and income level. The economy of Yemen was more stable towards the end of 2012. Despite the worsening security situation, the country maintained a stable crude oil export level. Energy export revenues, both in crude oil and in liquefied natural gas, sustained the domestic demand in Yemen from falling further. Furthermore, financial support for the transition of Yemen was actively pledged at both the regional and international levels. Other Arab least developed countries, namely the

Comoros, Djibouti and Mauritania, marked moderate GDP growth in 2012, which has made only a weak contribution to those countries' national income levels. The economic outcome of political stabilization in Somalia was still uncertain in 2012.

17. For 2013, the real GDP growth of the Arab least developed countries is projected to average 3.2 per cent. The stable growth in energy and natural resource exports is expected to buoy the growth of Mauritania and Yemen. The economic prospects of the Comoros and Djibouti depend largely on those of their neighbouring countries, which are expected to be stable. The Sudan is expected to mark positive growth after a two-year economic decline. The severe foreign exchange constraint is expected to remain, but its extent is expected to be relaxed owing to consistent growth in non-energy exports. The growth prospects of Arab least developed countries, however, are too weak to reduce the prevailing poverty level. In 2013, the forecasted growth rate is 3.5 per cent for the Comoros, 4.8 per cent for Djibouti, 6.3 per cent for Mauritania, 2.5 per cent for the Sudan and 4.5 per cent for Yemen.

18. The average consumer price inflation in the Arab region is estimated to be 5.5 per cent in 2012, compared with 4.9 per cent in 2011 (see table 2). Although the international commodity prices of energy, metal and food items hovered at a higher level, no extreme price spikes were observed throughout 2012. While the pass-through from international commodity markets had less impact, each country's consumer inflation level was determined more by country-specific factors. Deflationary pressure remained on housing-related items in Bahrain, Qatar and the United Arab Emirates. The weak property rent contributed to this trend, owing to the oversupply of rental properties, which became apparent after the global financial crisis of 2008-2009. In contrast, Oman and Saudi Arabia were under constant inflationary pressure, including on housing-related items, due to their sustained growth of the real estate sector. Nevertheless, GCC countries averaged a lower consumer inflation rate compared with other subregions, averaging 2.2 per cent in 2012. Other countries in the Arab region, with the exception of Morocco, experienced a higher consumer inflation rate than GCC countries in 2012. The structural supply bottlenecks resulted in hovering consumer prices in the Mashreq, the Maghreb and Arab least developed countries, and inflation was notably accelerated in the countries under foreign exchange constraints, namely Egypt, the Sudan and the Syrian Arab Republic. The upward shift of the private sector wage level in parallel with recent wage hikes in the public sector was observed in GCC countries, but the shift is not expected to influence the inflation rate of those countries.

19. The forecasted consumer price inflation rate of the Arab region averages 4.8 per cent in 2013. The low-inflation regime of GCC countries is expected to continue. Food prices have been observed to increase since 2012, but the price increase is expected to be moderate. Moreover, the price of housing-related items, such as property rents, is projected to be depressed in Bahrain, Kuwait, Qatar and the United Arab Emirates. Although the exceptionally high inflation rates in the Sudan, the Syrian Arab Republic and Yemen in 2012 are expected to taper off in 2013, the seriously binding foreign exchange constraint is anticipated to push up the price level of those countries. Egypt is also expected to experience accelerating inflation due to the foreign exchange constraint with the devaluation of its national currency. GCC countries may implement another round of wage hikes in the public sector in 2013, but its influence on the general price level is expected to be limited. With the exception of limited professional occupation categories in GCC countries,

the region's private sector wage level is expected to stay depressed, and wage-push inflation is not likely to take place in the region in 2013. GCC countries are in surplus with regard to their fiscal and external accounts and are in a position to maintain sufficient supply capacity for domestic demand growth. In other subregions, as the private sector wage level is expected to be depressed throughout the year, the only channel of wage-push inflation can be the public sector. A public sector wage hike has been proposed in a few countries, most notably Lebanon, since 2012, but its impact on inflation projection remains uncertain.

20. The exchange rates of the ESCWA/Arab region remained stable from 2012 to early 2013, with the exception of Egypt, the Sudan and the Syrian Arab Republic. GCC countries, with the exception of Kuwait, have kept their foreign exchange rate regime, pegging their currencies to the United States dollar. Djibouti, Jordan and Lebanon have also maintained their national currencies' pegging to the United States dollar. Kuwait has maintained the pegging of the national currency to the basket of foreign currencies. The central banks of Algeria, Comoros, Iraq, Libya, Mauritania, Morocco, Tunisia and Yemen have maintained a managed float regime. In the Sudan and the Syrian Arab Republic, the rapid decline in the value of the national currency widened the spread between the official exchange rate and the exchange rate of parallel markets; foreign currencies were practically rationed in those countries. Economic sanctions and other non-economic events largely contributed to the national currency depreciation in the Sudan and the Syrian Arab Republic, whereas the depreciation of the Egyptian pound (LE) was caused more by economic environments. In the space of three months since December 2012, the Egyptian pound depreciated by 8 per cent, to LE 6.8 per United States dollar in March 2013. Before this abrupt devaluation, the Egyptian pound had been effectively pegged to the United States dollar from April 2011 to December 2012 as a nominal anchor for the Egyptian economy to weather the unstable political and social situation in the country. Before that period, throughout 2010, the Egyptian pound gradually depreciated by 7 per cent, from LE 5.4 per dollar to LE 5.8 per dollar, but this gradual depreciation policy was replaced by the currency peg in effect. The currency peg regime was effective in maintaining the level of domestic demand during the highly turbulent period. However, it resulted in the rapid dwindling of the foreign reserves, from $28 billion in April 2011 to about $15 billion in February 2012. The resumption of a gradual depreciation policy was not taken promptly owing to the view that a currency devaluation could cause an immediate fiscal crisis by increasing food and energy subsidies and could have only a modest impact on the competitiveness of Egyptian exports. A gradual depreciation of the Egyptian pound is expected to continue in 2013, but the key to an orderly resolution of the present balance of payment crisis in Egypt would critically rest on the prospects of fiscal reform.

21. The armed violence in the Syrian Arab Republic and the destruction of commercial and residential properties, infrastructure and production facilities have already caused significant economic damage. It was estimated that GDP in real terms contracted by 31.4 per cent in 2012. The contraction of GDP was not due to the suspension of economic activities and the idle production capacity. Rather, it was due to the damage to physical capital stock and the loss of human capital. Even with the most optimistic scenario, it would take at least a few years for the Syrian economy to return to its 2010 levels. Economic sanctions imposed by the United States, the European Union and the League of Arab States caused a severe foreign

exchange constraint. Since the financial sanctions and oil embargo were imposed in 2011, the Syrian economy lost a substantial amount of export revenues and its trade facilitation capacity was hampered by difficulties in trade financing. The national currency, the Syrian pound (SP), gradually depreciated from the official exchange rate of SP 47.1 per United States dollar in January 2011 to SP 87.09 per United States dollar in March 2013, with a widening spread between the official rate and the parallel market rate. The loss of value of the national currency and the destruction of domestic transport networks caused hyperinflation. The year-on-year consumer inflation rate surged from 5.8 per cent in November 2011 to 49.7 per cent in November 2012.

22. Despite the magnitude of the violence and destruction, the Syrian economy exhibited its resilience as it avoided coming to a complete halt. Financial institutions are still in operation, and international trade with neighbouring countries continued, albeit with a reduced amount. For example, according to Lebanese customs data, Syrian exports to Lebanon in January 2013 stood at $16.0 million, or 56 per cent of the pre-crisis monthly average in 2010. The neighbouring countries felt the impact of the crisis not only in the reduced amount of trade through Syria but also in the spillover of geopolitical tensions. The crisis adversely affected risk perception in the Mashreq subregion. The inflow of capital and tourists, which had been the main driver of recent economic expansion in Jordan and Lebanon, was stagnant. Moreover, the rapidly increasing number of Syrian refugees to Jordan and Lebanon has put an additional fiscal burden on both countries. At the end of March 2013, the Office of the United Nations High Commissioner for Refugees (UNHCR) estimated the number of Syrian refugees at 1.23 million, of which 396,000 refugees stayed in Lebanon and 394,000 stayed in Jordan.[2] As at 15 March 2013, only 31 per cent of the required level for the UNHCR regional response plan was funded.[3]

IV. Policy developments

23. The economic environment that policymakers faced in 2012 grew remarkably different between major energy exporters, namely GCC countries, and other subregions in the Arab region. At the risk of domestic demand stagnation and continuing deflationary pressures, the Governments in GCC countries could adopt a mix of expansionary fiscal and monetary policies. This expansionary policy path was sufficiently sustainable for the ample fiscal space due to the growing energy export revenues and the continuing monetary easing of the United States. GCC countries' monetary policy mirrors that of the United States through the currency peg. By contrast, the Governments of other subregions were under pressure to implement further fiscal consolidation through austerity measures. Monetary policy has also tightened in energy-importing countries in the Mashreq and the Maghreb. To combat the rising inflationary pressure from worsening foreign exchange constraints, central banks in Egypt, Jordan and Tunisia tightened their monetary stances early in 2013. A clear policy dilemma arose in energy-importing countries in

[2] UNHCR, data available from the Syria regional refugee response inter-agency information-sharing portal (http://data.unhcr.org/syrianrefugees/regional.php). The number pertains to "persons of concern", which is the total number of refugees, both registered and awaiting registration.

[3] UNHCR, "Revised Syria regional response plan: funding status as of 15 March 2013". Available from http://data.unhcr.org/syrianrefugees/regional.php.

the Mashreq and the Maghreb as a much-needed pro-growth mix of fiscal and monetary policy became unaffordable.

24. Despite the limited latitude of monetary policy in GCC countries with regard to their currencies' link to the United States dollar, the relatively stable general price level allowed central banks in GCC countries to maintain an easing stance comfortably in parallel with the policy stance of the United States monetary authority. The funding cost in terms of the three-month interbank money market has converged around 1.0 per cent among GCC countries, 70 basis points higher than the three-month United States dollar London Interbank Offered Rate. The policy shift towards monetary easing was seen in Yemen, where the Central Bank of Yemen lowered policy interest rates in October 2012 and February 2013 to 15 per cent. A neutral monetary stance was maintained in Algeria, Lebanon and Morocco. Monetary policy was tightened in Egypt, Jordan, the Sudan and Tunisia in order to cope with inflationary pressures from binding foreign exchange constraints. In March 2013, the Central Bank of Egypt raised policy interest rates for the first time since November 2011, which resulted in an overnight deposit rate of 9.75 per cent. The Central Bank of Jordan raised its policy rates in February, June and December 2012, as a result of which the overnight deposit rate reached 4.0 per cent. The Central Bank of Tunisia raised its policy interest rate in August 2012 and March 2013 to 4.0 per cent.

25. For the fiscal year covering 2012 and 2013, the fiscal stance of GCC countries remained expansionary. The emphasis on infrastructure investment, health and education and social provision continued. The main challenge for GCC countries in the fiscal policy area was not the size but the scope. It became increasingly important to implement budgeted projects effectively in order to attain such long-term policy goals as improvement in productivity. The boom in fiscal revenue could easily result in an increase in an income transfer type of fiscal outlay rather than public investment for physical or human capital formation. With the chronic high unemployment of their nationals, GCC countries are keen on strategizing fiscal policy with a comprehensive development plan in both the economic and social spheres. By contrast, the energy-importing countries in the Mashreq and the Maghreb and among the Arab least developed countries struggled to form and implement fiscal austerity measures in the fiscal year covering 2012 and 2013. With the need for fiscal consolidation, food and energy subsidy reform has become the main policy focus of the Governments. Attaining consensus on the reform while assuring a basic living standard for the low-income populations will be a challenging priority in forming fiscal policy measures for the forthcoming fiscal years.

26. The employment situation worsened in the Arab region in 2012. In addition to the existing chronically high unemployment among their nationals, the prolonged economic slump in North America and Europe discouraged immigration on the part of the region's job seekers. A sizeable number of return migration cases from Europe were observed in the Maghreb. The employment situation in GCC countries remained unbalanced, as foreign workers constitute the majority of the workforce in the private sector. In spite of their consistently expanding domestic economy, GCC countries' labour markets remained a combination of high unemployment for the nationals and low unemployment for the foreign workers. A policy to increase the share of nationals in the private sector workforce has been in place for more than a decade in GCC countries. In 2012, more stringent application of this policy became

a trend in GCC countries. A case in point is Saudi Arabia, where, since November 2012, firms that do not employ a legally set proportion of Saudi nationals in the workforce are fined. Saudi Arabia also campaigned for the promotion of female employment. More occupational classes in the private sector were opened for female job seekers, and several government ministries initiated the employment of female workers. Moreover, 30 prominent female figures were appointed to the Shura (Consultative) Council for the first time in the country's history. The gradual shift of labour policy in Saudi Arabia is expected to have an impact not only in GCC countries but also in other subregions.

V. Concluding remarks

27. On average, the GDP growth rate of the Arab region is likely to taper off in 2013 owing to the decline in energy export revenues, which marked a historical high in 2012. However, it should be noted that it is increasingly difficult to provide a simple projection on economic and social developments in the region for 2013. Economic and social developments in the region are anticipated to become further polarized, and several signs of further segmentation have already been observed. Moreover, it has been observed that the region is exposed to the downside risk of dependence on energy exports. In spite of the active policy efforts towards economic diversification, major energy-exporting countries are still far from the diversification targets. As the region's non-energy sector in the Mashreq and the Maghreb has weakened, the Arab region's economy has become more vulnerable to an abrupt energy price plunge, although it is projected that an oil price plunge to the extent of 2008 levels is unlikely. A strong recovery in terms of confidence in intraregional business transactions is not foreseen, considering the unstable political situation in the Mashreq. However, it is the structural weakness of the economies in the Arab region, represented by high unemployment rates and income inequalities, that has been argued as the chronic undercurrent of motivation for social unrest and political instability. Thus, social unrest and political instability are not necessarily the cause of economic underperformance but can be the result of it. In order to keep the Arab region from falling into this vicious circle, effective regional leverage for economic activities through further regional cooperation frameworks and regional integration efforts needs to be augmented.